



**Subject:** Agenda for the 109<sup>th</sup> meeting of the AUASB  
**Venue:** The Portside Centre, Level 5, 207 Kent Street, Sydney  
**Time:** Wednesday 12 June 2019 9:30am – 5:30pm and  
Thursday 13 June 2019 8:45am – 4:30pm

\* NB: Agenda items 1, 7, 14 & 15 are closed sessions

## DAY 1

Time	Agenda Item No.	Resp.
9.30am	<b>1. Preliminary Session*</b>	
	1.1 Welcome (verbal update)	Roger
	1.2 AUASB Declarations of Interest	Roger
	1.3 Approval of Minutes of Previous AUASB Meetings	Roger
	1.4 Matters Arising from Previous Meetings	Matthew
	1.5 AUASB Speaking Register	Roger
	1.6 Update from the AUASB Chair (verbal update)	Roger
	1.7 AUASB Meeting Register	Matthew
	1.8 NZAuASB Update (verbal update)	Robert
10:15am	<b>2. IAASB June 2019 Meeting</b>	
	2.1 ISA 315 <i>Risks of Material Misstatement</i>	Anne / Matthew Fiona Campbell
11:00am	<i>Morning Tea</i>	
	2.2 ISA 600 <i>Group Audits</i>	Rene
	2.3 Audit Evidence	Tim
	2.4 ISRS 4400 <i>Agreed Upon Procedures</i>	Rene
12:45pm	<i>Lunch</i>	
1:30pm	2.5 Auditor Reporting Implementation Review	Anne
	2.6 Other IAASB Items (verbal update)	Matthew
2:00pm	<b>3. Quality Management Standards Submission</b>	Rene / Tim
3:45pm	<i>Afternoon Tea</i>	
4:00pm	<b>4. GS 005 Using the Work of a Management's Expert [Draft]</b>	Rene
4:30pm	<b>5. Guidance Statement Revision Plan</b>	Tim / Jean
5:15pm	<b>6. GS 008 Project Plan</b>	See-Wen
5:30pm	Day 1 Close	



<b>Subject:</b>	<b>Agenda for the 109<sup>th</sup> meeting of the AUASB (continued)</b>
<b>Venue:</b>	<b>The Portside Centre, Level 5, 207 Kent Street, Sydney</b>
<b>Time:</b>	<b>Wednesday 12 June 2019, 9:30am – 5:30pm</b> <b>Thursday 13 June 2019, 8:45am – 4:30pm</b>

\* NB: Agenda items 1, 7, 14 & 15 are closed sessions

## DAY 2

Time	Agenda Item No.	Resp.
	<b>7. FRC / Audit Quality Update*</b>	
8:45am	<ul style="list-style-type: none"> <li>• FRC Update (verbal update)</li> <li>• Future AUASB/FRC collaboration on Audit Quality</li> <li>• UK Audit Developments</li> <li>• Monitoring Group update</li> <li>• NZ FMA Perceptions of Audit Quality Report</li> <li>• AUASB Discussion on ACC and Investor Surveys</li> </ul>	Anne / Roger
10:00am	<b>8. AUASB EER Submission</b>	Marina
10:45am	<i>Morning Tea</i>	
11:00am	<b>9. Not-For-Profit Sector Auditing and Assurance Issues</b>	Tim
	<b>10. Auditor implications arising from AASB ED's on Removal of Special Purpose Accounts</b>	Anne
	<b>11. Public Sector PAG Update (verbal update)</b>	Matthew
	<b>12. AUASB Forward Agenda</b>	Jean
	<b>13. Other Business</b>	
	13.1 Submission on IAASB Proposed 2020-23 Strategy	Matthew
	13.2 Revision of APRA Approved Audit Forms (verbal update)	Marina
	13.3 2020 AUASB Meeting Dates (verbal update)	Rene
12:30pm	<b>14. AUASB Review*</b>	Roger
1:00pm	<i>Lunch</i>	
	<b>15. AUASB/AASB Joint Meeting*</b>	
1:30pm	<ul style="list-style-type: none"> <li>• Welcome and introduction</li> <li>• Update on last joint meeting held June 2018</li> <li>• Review of strategic plan</li> <li>• Board processes discussion</li> <li>• Next steps</li> </ul>	
4:pm	Day 2 Close	



**AGENDA PAPERS**  
Auditing and Assurance Standards Board – Meeting 109, 12-13 June 2019

Agenda Number	Document Title	Page # in combined
	<b>AUASB Meeting Agenda</b>	
1.2.1	Declaration of interest <b>(Board Only)</b>	1
1.3	Minutes of Previous AUASB Meetings – 16 April 2019 <b>(Board Only)</b>	3
1.4.1	Matters arising from Previous Meeting <b>(Board Only)</b>	6
1.5.1	AUASB Speaking Register <b>(Board Only)</b>	7
1.7	AUASB Meeting Register <b>(Board Only)</b>	9
<b>2.</b>	<b>IAASB June 2019 Meeting</b>	
2.1.0	BMSP ISA 315	12
2.1.1	IAASB ED 315 Extract	24
2.2	BMSP Group Audits	94
2.3.0	BMSP Audit Evidence	100
2.3.1	IAASB Audit Evidence Extract	102
2.4	BMSP Agreed-Upon Procedures	133
2.5	BMSP Auditor Reporting Implementation Review	136
<b>3.</b>	<b>Quality Management Standards Submission</b>	
3.0	BMSP Quality Management Standards	146
3.1	EM ISQM 1 <i>Quality Management for Firms that Perform Audit Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements</i>	148
3.2	EM ISQM 2 <i>Engagement Quality Reviews</i>	266
3.3	EM ISA 220 <i>Quality Management at the Engagement Level</i>	309
3.4	Attachment to BMSP QM Standards	373
<b>4.</b>	<b>GS 005 <i>Using the Work of a Management's Expert</i> [Draft]</b>	
4.0	BMSP GS 005	378
<b>5.</b>	<b>Guidance Statement Revision Plan</b>	
5.0	BMSP Guidance Statement Revision Plan	382
<b>6.</b>	<b>GS 008 Project Plan</b>	



Agenda Number	Document Title	Page # in combined
6.0	BMSP GS 008	387
6.1	GS 008 Project Plan	389
<b>7.</b>	<b>FRC / Audit Quality Update</b>	
7.0	BMSP Audit Quality ( <b>Board Only</b> )	391
7.1	FRC Summary of Audit Quality Literature ( <b>Board Only</b> )	399
<b>8.</b>	<b>AUASB EER Submission</b>	
8.0	BMSP EER	402
8.1	AUASB Submission on the IAASB's Consultation Paper: <i>EER Assurance</i> [Draft]	404
<b>9.</b>	<b>Not-for-Profit Sector Auditing and Assurance Issues</b>	
9.0	BMSP Not-For-Profit Sector Auditing and Assurance Issues	415
<b>10.</b>	<b>Auditor Implications Arising from AASB ED's on Removal of Special Purpose Accounts</b>	
10.0	BMSP Auditor Implications of Removal of Special Purpose	422
<b>12.</b>	<b>AUASB Forward Agenda</b>	
12.0	BMSP AUASB Forward Agenda	427
<b>13.</b>	<b>Other Business</b>	
13.1	Final AUASB Submission on IAASB Proposed Strategy & Work Plan 2020-2023	430



**AUASB DECLARATION OF INTERESTS**

**29<sup>th</sup> May 2019**

<b>AUASB Member</b>	<b>Professional Affiliations</b>	<b>Listed Entity Affiliations</b>	<b>Other Relevant Matters</b>
Dr Roger Simnett (Chair)	Fellow, CPA	Nil	<p>Scientia Professor, UNSW Sydney</p> <p>Member, International Auditing and Assurance Standards Board</p> <p>Member, New Zealand Auditing Standards Board</p> <p>Member, International Integrated Reporting Council Working Panel</p> <p>Member, Financial Reporting Council (FRC) Australia</p> <p>Member, World Business Council for Sustainable Development Assurance Working Group</p>
Ms Robin Low (Deputy Chair)	FCA GAICD	<p>Director, AUB Group Limited</p> <p>Director, CSG Limited (CSV)</p> <p>Director, IPH Limited (IPH)</p> <p>Director, Appen Limited (APX)</p>	<p>Director, Public Education Foundation Ltd</p> <p>Director, Primary Ethics Ltd</p> <p>Member, CA ANZ Professional Conduct Committee</p> <p>Director, Australian Reinsurance Pool Corporation</p> <p>Director, Gordian Runoff Limited</p> <p>Director, Enstar Australia Holdings Pty Ltd</p> <p>Member, AICD Reporting Committee</p> <p>Receives PwC retired partner pension</p>
Mr Gareth Bird	<p>Member, CA ANZ</p> <p>Member, SAICA (South African Institute of Chartered Accountants)</p>	Nil	Partner, Deloitte

Mr Robert Buchanan	Barrister and Solicitor of the High Court of New Zealand  Member of the Institute of Directors in New Zealand	Nil	Chairman, NZAuASB  Barrister sole (Wellington, New Zealand)  Board Chairperson, Low Volume Vehicle Technical Association Inc (a New Zealand not-for-profit entity)  Trustee of a family trust  Director, ProbitManager Limited (NZ-registered company)  Committee member of a body corporate (NZ)
Ms Jo Cain	GAICD	Nil	Banksia Foundation: Chair Audit and Risk Committee Workways Australia: Member Audit and Risk Committee IAASB Emerging Forms of External Reporting (EER) Project Advisory Panel (PAP): Member  International Integrated Reporting Council (IIRC) Technical Review Panel: Member  Materiality Counts: Executive Director
Ms Julie Crisp	RCA, ASIC  FCA  FCPA  FGIA  GAICD  CIA, IIA  CGAP, IIA  CRMA, IIA  Member, ACFE	Nil	Member, Australasian Council of Auditors-General (ACAG)
Dr Noel Harding	CPA	Nil	Associate Professor, UNSW Sydney Member, Editorial Board of International Journal of Auditing Member, Editorial Board of Behavioral Research in Accounting  Chair, Communications Committee of American Accounting Association Auditing Section
Ms Carolyn Ralph	Fellow,  CA ANZ		Partner, KPMG
Mr Justin Reid	Member,  CA ANZ	Nil	Owner at Justin Reid Consulting  Director of Technical Audit Solutions Pty Ltd
Mr Rodney Piltz	Member, CA ANZ	Nil	Partner, Ernst & Young
Mr Klynton Hankin	Member, CA ANZ	Nil	Partner, PWC



**Subject:** Minutes of the 108<sup>th</sup> meeting of the Auditing and Assurance Standards Board (AUASB)  
**Venue:** TEQSA Executive Board Room, Level 14, 530 Collins Street, Melbourne VIC 3000  
**Date:** Tuesday 16 April 2019 9:00am – 5:00pm

## Attendance

AUASB Members: Professor Roger Simnett (Chair)  
Ms Robin Low (Deputy Chair)  
Mr Gareth Bird  
Mr Robert Buchanan  
Mr Klynton Hankin  
Dr Noel Harding  
Ms Carolyn Ralph  
Mr Justin Reid (via teleconference for Agenda Item 5)

AUASB Technical Group: Mr Matthew Zappulla  
Ms Rene Herman  
Ms Marina Michaelides  
Ms Anne Waters  
Mr Tim Austin

Apologies: Ms Jo Cain  
Ms Julie Crisp  
Mr Rodney Piltz

## Minutes

### (Agenda Item 1 – Minute 1260) Agenda and introduction

The AUASB Chair welcomed members to the 107<sup>th</sup> AUASB meeting.

### (Agenda Item 1.3 – Minute 1261) Minutes of Previous AUASB Meetings

Draft minutes for the AUASB meetings held on 6 March 2019 and 20 March 2019 (via Teleconference) were discussed and approved by the AUASB Chair.

### (Agenda Item 2 – Minute 1262) Report on IAASB March 2019 Meeting

The AUASB Chair and AUASB Technical Director provided AUASB Members with a report on the IAASB's March 2019 meeting, the first since the AUASB Chair was appointed to the IAASB.

The key developments at the meeting were the IAASB's progress on addressing stakeholder's concerns about the length, complexity and scalability of the proposed ISA 315 *Identifying and Assessing the Risks of Material Misstatement* and a new *Less Complex Entities Discussion Paper*.

In relation to ISA 315, most feedback provided by the AUASB in its submission sent in November 2018 had been addressed by the ISA 315 Task Force. Following extensive feedback from stakeholders a major revision to the requirements of the standard is planned, so it is not expected to be approved until September 2019 and could be possibly delayed to December 2019.

The IAASB were supportive of the draft Less Complex Entities Discussion Paper (DP) and provided suggestions for improvement. The DP is expected to be approved via Teleconference in time for the Paris Small and Medium Practices conference. A key implication for the AUASB will be effectively engaging Australian stakeholders to respond to the DP once released, particularly from small and medium audit practitioners.



**(Agenda Item 3 – Minute 1263) Update of International Influence Strategy**

The AUASB were presented with an updated version of the AUASB International Strategy, which describes how the AUASB influences and engages on International auditing and assurance matters to support its mandate and domestic agenda, for review. The International Strategy was last revised at the April 2018 AUASB meeting and was updated to reflect changes made to the AUASB exposure draft process agreed at the March 2019 AUASB meeting, as well as other updates to terminology and minor editorial changes.

AUASB members provided suggested changes to the updated AUASB International Strategy document. These will be processed by the AUASB Technical Group and then published on the AUASB Website at <https://www.auasb.gov.au/admin/file/content102/c3/AUASBInternationalStrategy-April2019.pdf>.

**(Agenda Item 4 – Minute 1264) Response to IAASB 2020-2023 Strategy**

AUASB members were requested to provide feedback on the IAASB's 2020-23 Strategy Consultation Paper and also the outreach and engagement activities planned to support the AUASB's Submission on this Consultation Paper due in late May 2019.

Board members gave feedback that the IAASB's proposed actions in the Consultation Paper did not adequately address all of the challenges identified in Strategy and that a greater nexus was necessary to demonstrate how the IAASB is responding to global issues impacting auditing and assurance on top of the current agenda. In particular the AUASB raised concerns that there should be an additional focus on implementation support and thought leadership, particularly in an environment where reporting frameworks impose a greater emphasis on accounting estimates that makes auditing more challenging.

The AUASB Technical Group were directed to revisit the AUASB's responses to the IAASB Strategy Survey submitted in July 2018 to ensure all matters previously shared with the IAASB in respect of its 2020-23 Strategy Consultation have been addressed. Outreach with AUASB stakeholders will be held in May 2019 to also obtain feedback on the 2020-23 Strategy, before a draft response is developed for AUASB review out of session in late May 2019.

**(Agenda Item 5 – Minute 1265) Final Outreach Plan for QM Standards, Less Complex Entities DP and IAASB Strategy**

The AUASB were presented with an overview of the outreach plan to gather input into the Quality Management Standards, IAASB Strategy and LCE Discussion Paper projects prepared by the AUASB Technical Group. Engagement and outreach activities will be held over May and June 2019, with targeted outreach planned for specific stakeholder groups, such as the large accounting firms and small/medium practitioners.

Board members provided comments requesting the AUASB Technical Group to target stakeholders broader than just auditors for these topics and also consider specific Webinars on certain subjects.

**(Agenda Item 6 – Minute 1266) ASRE 2410 – EER Phase 1 Feedback**

The AUASB discussed the IAASB Extended External Reporting (EER) Phase 1 guidance consultation paper and provided feedback on key areas raised by the AUASB Technical Group and the proposed outreach plan. The AUASB Technical Group will continue to progress the submission to the IAASB and further input from the AUASB will be sought in early June 2019 before the final submission on this topic to the IAASB is due.

**(Agenda Item 7 – Minute 1267) Approval of the ED for ASRE 2410**

The AUASB reviewed the updated draft of Exposure Draft ED 05/19 Proposed Auditing Standard on Review Engagements ASRE 2410 *Review of a Financial Report Performed by the Auditor of the Entity*.

The AUASB previously agreed that the scope of the update of ASRE 2410 was to align the format of the review report to the format of the auditor's report in ASA 700 *Forming an Opinion and Reporting on the Financial Report*, and conforming amendments as a result of changes to ASA 250 *Consideration of Laws and Regulations in the Audit of a Financial Report*.

The AUASB discussed whether the requirements in extant ASRE 2410 paragraph 19 which require the auditor to make enquiries about going concern were sufficient, in particular because the application guidance suggests that the auditor considers whether it is necessary to perform other corroborative procedures. As





this approach is consistent with ISRE 2410, and the specific procedures in relation to going concern are considered outside the scope of this update to ASRE 2410, the AUASB agreed not to amend ASRE 2410 for this matter.

The AUASB requested that further amendments were made to ED 05/19 to align with the reporting requirements of ASA 570 *Going Concern*. The AUASB also agreed to remove Illustrative review report *Example of an Auditor's Review Report With a Qualified Conclusion (Except for) On the Basis that Comparatives Have Not Been Reviewed or Audited*, as this scenario is not consistent with ASRE 2410 paragraph 21 and is already addressed in ASA 510 *Initial Audit Engagements - Opening Balances*.

Subject to these agreed amendments being updated and approved by the AUASB Chair out of session, the AUASB were asked to vote to approve the issue of the Exposure Draft for a 90 day exposure period. This vote was approved unanimously, with 8 members voting for and none against.

#### **(Agenda Item 8 – Minute 1268) Update on AUASB Guidance Statements**

The AUASB evaluated a plan for reviewing and prioritising existing AUASB Guidance Statements based on an agreed set of criteria. AUASB Members provided comments on the priority that should be allocated to each criteria and suggested additional criteria to consider. Based on this feedback a full plan for the update of AUASB Guidance Statements will be presented to the AUASB at its June 2019 meeting.

The AUASB received an update on the revision of GS 005 *Using the Work of a Management's Expert*, for which a first draft will be brought to the June 2019 AUASB meeting for discussion. Preliminary work is also currently underway to review GS 012 *Prudential Reporting Requirements for Auditors of ADIs* and GS 009 *Auditing Self-Managed Superannuation Funds*.

#### **(Agenda Item 9 – Minute 1269) Public Sector Audit Issues Project Advisory Group Update**

The AUASB Technical Director provided an update to the AUASB on the first two Public Sector Audit Issues Project Advisory Group (PAG) Meetings held in March and April 2019. The scope of the PAG at this stage has been focussed on the matters raised by the Australasian Council of Auditors-General (ACAG) in their formal correspondence to the AUASB. The PAG are currently discussing how each issue raised by ACAG impacts their jurisdiction and the possible standard-setting options available under the AUASB framework.

#### **(Agenda Item 10 – Minute 1270) AUASB Forward Agenda**

The AUASB noted an updated version of the AUASB Forward Agenda, outlining the planned items for consideration at future AUASB meetings for the rest of 2019.

#### **Next Meeting**

The next regular meeting of the AUASB will be held in Sydney, on Wednesday 12<sup>th</sup> June and Thursday 13<sup>th</sup> June 2019.

#### **Close of Meeting**

The Chair closed the meeting at 5.00 p.m.

#### **Approval**

Signed as a true and correct record.

Roger Simnett  
Chair

Date: 12 June 2019

**Matters Arising from Previous Meetings and Action List**  
**Agenda item 1.4.1: AUASB Meeting 12-13 June 2019**



**Australian Government**  
**Auditing and Assurance Standards Board**

Status	Definition
Suspended	Will not be actioned in short-term
Pending	Yet be actioned
Outstanding	Matter ongoing - still to be actioned
In-progress	Progressing as expected
Completed	Matter resolved

Colour	Priority
Red	High
Green	Normal

Meeting Date	Action #	Matter Arising	Custodian	Status	Targeted completion	Comments
16-Apr-19	108.01	Finalise AUASB submission on IAASB EER Phase 1 Guidance Consultation	Marina	In-progress	12-Jun-19	Refer to Agenda item 2.
16-Apr-19	108.02	Further amendments to ASRE 2410 ED 05/19 to be made before issuing (removing an illustrative review report and aligning requirements re going concern to ASA 570)	Anne	Completed	12-Jun-19	Refer to April 2019 AUASB Meeting Agenda item 7.
16-Apr-19	108.03	Full Guidance Statement revision plan to be brought to the AUASB	Tim	In-progress	12-Jun-19	Refer to Agenda item 5.
16-Apr-19	108.04	Provide reconciliation of the AUASB response to the IAASB Strategy Survey (2018) with IAASB 2020-23 Strategy Submission	Matthew	Completed	12-Jun-19	To be distributed to AUASB Members out of session with the draft submission.
6-Mar-19	106.01	Update the international strategy based on ED process discussion.	Matthew	Completed	16-Apr-19	Refer to April 2019 AUASB Meeting Agenda item 3.
6-Mar-19	106.02	Review and discuss ED process trialled with QM standards and update process documents to reflect agreed process.	Matthew	Pending	3-Dec-19	To be actioned in second half of 2019 following exposure of Quality Management Standards.
6-Mar-19	106.03	Provide reconciliation of AUASB matters raised in response to IAASB matters following and proceeding the review of IAASB papers at each AUASB meeting.	Matthew	In-progress	12-Jun-19	Refer to Agenda item 2.
4&5 Dec 19	105.2	Share FRC Literature Review in respect of Audit Quality measures with AUASB Members	Anne	In-progress	12-Jun-19	Refer to Agenda item 7.
4&5 Dec 19	105.3	Board discussion about the IAASB's direction and the trend of standards no longer being fit for purpose for all stakeholders	Roger	Completed	16-Apr-19	Discussion was integrated with review of IAASB Strategy at April 2019 AUASB Meeting.
4&5 Dec 19	105.5	Final EISS Strategy to incorporate AUASB Feedback	Anne	In-progress	16-Apr-19	Refer to Agenda item 13.
4&5 Dec 19	105.6	Update and review of ASRE 2410 ED	Anne	Completed	6-Mar-19	Refer to April 2019 AUASB Meeting Agenda item 7.
4&5 Dec 19	105.7	Review of plan for update of all AUASB Guidance Statements	Tim	In-progress	16-Apr-19	Refer to Agenda item 8.
4&5 Dec 19	105.10	Draft of Assurance Framework Bulletin	Tim	Pending	16-Apr-19	Deferred to September 2019 AUASB meeting.
4&5 Dec 19	105.12	Maintain list of DA references for AUASB Board members in Dropbox	Jean	Pending	TBD	AUASB Technical Group currently working on this task.
4&5 Dec 19	105.13	Updated GS012 project plan and update on PAG	Matthew	Pending	16-Apr-19	Deferred to September 2019 AUASB meeting.
4&5 Dec 19	105.15	Update on ISA/ASA 540 Implementation Guidance and Activities	Rene	Outstanding	16-Apr-19	Deferred to September 2019 AUASB meeting.
4&5 Dec 19	105.16	Update on GS 005 PAG	Rene	In-progress	16-Apr-19	Refer to Agenda item 8.
4&5 Dec 19	105.17	Public Sector PAG Update	Matthew	In-progress	16-Apr-19	Refer to Agenda item 11.
4&5 Dec 19	105.18	AUASB review and submission on IAASB 2020-2023 Strategy Consultation Paper.	Matthew	In-progress	16-Apr-19	Refer to Agenda item 13.
12-Sep-18	103.02	Arrange a guest presentation for the December AUASB meeting on data analytics and technology.	Matthew	Outstanding	16-Apr-19	Deferred to December 2019 AUASB Meeting.
12-Sep-18	103.03	Develop criteria to determine when submissions require AUASB approval as opposed to Chair approval.	Roger	Outstanding	16-Apr-19	Deferred to September 2019 AUASB Meeting.
12-Sep-18	103.07	Hold discussion at December AUASB meeting on the implications for the AUSAB framework arising from the FRC/AUASB report on Audit committee chair perception of audit quality.	Anne	In-progress	16-Apr-19	Refer to Agenda item 7.
13-Jun-18	101.02	Request for AUASB Technical Group Members to attend any Firm data analytics / audit technology related training courses or briefings provided to ASIC.	Board Members	In-progress	Ongoing	Data & Analytics training for AUASB staff and Chair being hosted by KPMG on 27 March 2019. Board members to advise Matthew if this opportunity arises.
28-Nov-17	97.05	Technical Group to seek and consider of feedback on ASAE 3450 and monitor NZAuASB project to determine if any amendments are needed to ASAE 3450	Anne	Pending	TBD	Technical group have requested Board Members to identify relevant persons due to the narrow applicability of this standard. NZAuASB to kick off this project shortly.
26-Jul-16	94.01	Revised guidance statement on Questions at AGMs. At November 2017 meeting (M97): - The AUASB did not consider this to be a priority project at this time; and - AUASB technical Group was requested to consider how to raise awareness of the enhanced auditor report in the investor/user community	Anne	Pending	TBD	AUASB Technical Group to provide plan for updating Guidance Statements at April 2019 AUASB Meeting.



# AUASB Board Meeting Summary Paper

**AGENDA ITEM NO. 1.5.1**

**Meeting Date:** 12<sup>th</sup> June 2019

**Subject:** AUASB Speaking Register

**Date:** 29/05/2019

**Action Required**

**For Information Purposes Only**

<i>Events since last AUASB Meeting</i>			
<b>Presenter</b>	<b>Date</b>	<b>Presenting to</b>	<b>Topic</b>
Roger Simnett Tim Austin	17 <sup>th</sup> April 2019	Reps from CPA Australia CA ANZ & ACNC	NFP Audit Quality Presentation
Tim Austin	14 <sup>th</sup> May 2019	CA ANZ Audit Conference ad	ASA 540 Presentation
Roger Simnett Rene Herman Matthew Zappaualla	06 <sup>th</sup> & 07 <sup>th</sup> May 2019	CA ANZ Audit Conference Melbourne	Audit Quality Panel ASA 540 Presentation QM Standards LCE Discussion Paper
Matthew Zappaualla	22 <sup>nd</sup> May 2019	CA ANZ Audit Conference Perth	Audit Quality Panel ASA 540 Presentation QM Standards LCE Discussion Paper
Roger Simnett Matthew Zappaualla	13 <sup>th</sup> – 15 <sup>th</sup> May 2019	IAASB NSS Meeting   Paris	AUASB Update & NSS Colab workshop
Roger Simnett	16 <sup>th</sup> – 17 <sup>th</sup> May 2019	SMP/SME IAASB Conference	LCE discussion paper
Roger Simentt Matthew Zappaualla Rene Herman Marina Michaelides	27 <sup>th</sup> May 2019	Sydney Large National Networks Group	Roundtable on QM Standards
Matthew Zappaualla Rene Herman	28 <sup>th</sup> May 2019	Melbourne Large National Networks Group	Roundtable on QM Standards
Matthew Zappaualla Rene Herman	30 <sup>th</sup> May 2019	Brisbane Large National Networks Group	Roundtable on QM Standards
Matthew Zappaualla Rene Herman	06 <sup>th</sup> June	Melbourne Large National Networks Group	Roundtable on QM Standards

*This document contains preliminary views and/or AUASB Technical Group recommendations to be considered at a meeting of the AUASB, and does not necessarily reflect the final decisions of the AUASB. No responsibility is taken for the results of actions or omissions to act on the basis of reliance on any information contained in this document (including any attachments), or for any errors or omissions in it.*

<b><i>Events since last AUASB Meeting</i></b>			
<b>Presenter</b>	<b>Date</b>	<b>Presenting to</b>	<b>Topic</b>
Roger Simnett	29 <sup>th</sup> May 2019	CPA Australia external reporting center of excellence	AUASB update
Roger Simnett	10 <sup>th</sup> May 2019	ASIC Accounting and Auditing standing committee	AUASB update

<b>Future Events</b>			
<b>Presenter</b>	<b>Date</b>	<b>Presenting to</b>	<b>Topic</b>
Roger Simnett Anne Waters	08 <sup>th</sup> July 2019	AFAANZ conference	

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## AUASB Meeting Register – June 2019

Organisation	Contact	Position	Who from AUASB	Frequency of Meeting	Last Contact Date
<b>Strategic Stakeholders – Domestic</b>					
ACAG Auditing Standards Committee	Andrew Richardson	Chair	Roger Simnett	Annually	11/10/2018
Australian National Audit Office	Grant Hehir	Auditor-General	Roger Simnett	Annually	07/12/2018
ACNC	Gary Johns	Commissioner	Roger Simnett	Annually	
ACNC	Mel Yates	Director	Matthew Zappulla / Tim Austin / Roger Simnett	6 monthly	6/2/2019
AFAANZ Auditing SIG	Robyn Moroney	Chair	Roger Simnett / Noel Harding / Anne Waters	6 monthly	23/1/2019
APESB	Nancy Milne	Chair	Roger Simnett	Annually	26/3/2019
APESB	Channa Wijesinghe	CEO	Matthew Zappulla	6 monthly	26/03/2019
APRA	Wayne Byres	Chair	Roger Simnett	Annually	
APRA	Rob Sharma	Head Accounting Services	Matthew Zappulla / Senior Project Manager	6 monthly	
ASIC	James Shipton	Chair	Roger Simnett	Annually	
ASIC	John Price	Commissioner	Roger Simnett /AUASB	Quarterly	16/04/2019
ASIC	Doug Niven	Head Accountant	Roger Simnett / Senior Project Manager	Quarterly	21/03/2019
CA ANZ	Rick Ellis	CEO	Roger Simnett	Annually	
CA ANZ	Amir Gandhar	Reporting and Assurance Leader	Matthew Zappulla	Quarterly	09/04/2019
CPA Australia	Andrew Hunter	CEO	Roger Simnett	6 monthly	



Organisation	Contact	Position	Who from AUASB	Frequency of Meeting	Last Contact Date
CPA Australia	Gary Pflugrath	Head of Policy and Advocacy	Roger Simnett / Matthew Zappulla	Quarterly	27/2/2019
CPA Australia	Claire Grayston	Senior Policy Advisor	Matthew Zappulla	Quarterly	27/2/2019
IPA	Andrew Conway	CEO	Roger Simnett	Annually	
AICD	Angus Armour	CEO	Roger Simnett	6 monthly	
<b>Strategic Stakeholders – International</b>					
AASB Canada	Ken Charbonneau	Chair	Roger Simnett / Matthew Zappulla	Quarterly	15/05/2019
IAASB (Canada)	Eric Turner	Member	Roger Simnett	Quarterly	15/05/2019
NBA (Netherlands)	Jan Thijs Drupsteen	Director	Roger Simnett / Matthew Zappulla	Quarterly	15/05/2019
NZAuASB	Robert Buchanan	Chair	Roger Simnett	Monthly	15/05/2019
NZAuASB	Sylvia Van Dyk	Director	Matthew Zappulla	Quarterly	15/05/2019
IAASB (Singapore)	Chun Wee Chiew	Member	Roger Simnett	Quarterly	11/3/2019
Nordic Federation	Per Hanstad	CEO	Roger Simnett	Annually	15/05/2019
IAASB (Japan)	Sayaka Sumida	Member	Roger Simnett	Quarterly	15/05/2019
IAASB	Arnold Schilder	Chair	Roger Simnett	Quarterly	15/05/2019
IAASB	Fiona Campbell	Deputy Chair	Roger Simnett	Quarterly	15/05/2019
IAASB Staff	Willie Botha	TD	Roger Simnett / Matthew Zappulla	6 monthly	15/05/2019
IAASB Staff	Beverley Bahlmann	Deputy	Roger Simnett / Matthew Zappulla	6 monthly	16/05/2019
IAASB (South Africa )	Imran Vanker	Member	Roger Simnett	Quarterly	11/3/2019
IIRC	Liz Prescott	Technical Director	Roger Simnett / Marina Michaelides	6 monthly	
<b>Other Stakeholders – Domestic</b>					
Australian Auditor Generals	Auditor Generals	A-G	Roger Simnett / Matthew Zappulla	As required	



Organisation	Contact	Position	Who from AUASB	Frequency of Meeting	Last Contact Date
Heads of Audit	Big 6 accounting firms	N/A	Roger Simnett	Annually	
ACAG	Rachel Portelli	Secretariat	Matthew Zappulla	Quarterly	
Department of Finance	Stein Helgeby	Deputy Secretary	Roger Simnett	6 monthly	28/2/2019
<b>Other Stakeholders – Domestic (continued)</b>					
AICD	Kerry Hicks	Senior Policy Advisor	Matthew Zappulla / Senior Project Manager	6 monthly	
ASX	Kevin Lewis	Board Member	Roger Simnett	6 monthly	
G100	Andrew Porter	CFO	Roger Simnett	Annually	
IIA	Peter Jones	CEO	Roger Simnett	Annually	



# AUASB Board Meeting Summary Paper

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**AGENDA ITEM NO.**            **2.1.0**

**Meeting Date:**                12 June 2019

**Subject:**                        ISA 315 Identifying and Assessing the Risks of Material Misstatement

**Date Prepared:**                5 June 2019

**Prepared by:**                 Anne Waters – AUASB Senior Project Manager

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**Action Required**

**For Information Purposes Only**

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## Agenda Item Objectives

1. To update and inform the AUASB on the IAASB's ISA 315 Task Force's proposed changes to respond to ED 315 *Identifying and Assessing the Risks of Material Misstatement* (ED 315), which is being presented at the June 2019 IAASB meeting;
2. To communicate to the AUASB how the matters raised in our submission on ISA 315 are being addressed; and
3. For the AUASB to provide views on the proposed changes contained in redrafted ISA 315 to AUASB Chair Roger Simnett in his capacity as an IAASB member.

## Background

4. The AUASB submitted a comment letter to the IAASB on ED 315 on 2 November 2018.
5. For the March 2019 IAASB Meeting the IAASB considered a detailed analysis of the 72 responses the IAASB received on ED 315 prepared by the ISA 315 Task Force, as well as agreed a new drafting style or approach to reduce the length and complexity of the requirements. Based on the feedback by the IAASB the ISA 315 Task Force have progressed changes to ISA 315 by focusing its efforts on implementing the new drafting style or approach, and the requirements.
6. The agenda item presented for discussion provides a substantially complete proposed revised standard with application material and appendices still to be finalised. Also the Introductory paragraphs and the automated tools and techniques content have not been finalised.
7. An analysis of the IAASB's Issues paper and proposals is summarised in this AUASB board paper – if AUASB members wish to review the full suite of materials relating to this IAASB Agenda Item refer to the [IAASB's](#) website (Refer IAASB 'Agenda Item 2 - ISA 315 (Revised)').

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## Matters to Consider

### Drafting style

8. The main theme throughout the responses to ED 315 was related to its complexity, as well as scalability and proportionality. There were also many comments related to individual aspects of the proposals, some supporting the specific changes that had been proposed, while other comments highlighted concerns or disagreement.
9. The ISA 315 Task Force have redrafted the requirements based on the new drafting approach. The requirements are the “what”, the application material, appendices and guidance is the “why” and “how”. There is substantial use of definitions to remove content from the requirements whilst maintaining the rigor of the requirements. As such, the requirements need to be considered with the supporting definitions. This is to achieve the objective of making the standard less complex, shorter and more understandable.
10. The ISA 315 Task Force have been considering whether moving content from the requirements to the definitions impacts the robustness of the ISA, and whether changes may be needed to ISA 200 to enhance the “authority” of the definitions? The IAASB are asked to consider this.
11. The phrase ‘relevant aspects’ has been introduced to the requirements to obtain an understanding of the entity and its environment, the applicable financial reporting framework and the entity’s system of internal control, highlighting that particular matters need to be understood to support the identification and assessment of the risks of material misstatement. The definitions include the detail on the components that make up the relevant aspects. For example paragraph 17 and 23 in redrafted ISA 315.

### Redrafted ISA 315

12. The AUASB Technical Group (ATG) have reconciled the matters raised by the AUASB in the submission to the IAASB on ED 315, and how they have been addressed in redrafted ISA 315. Refer to the table below. Based on this the ATG have raised additional questions for the AUASB’s consideration.
13. As a result of the new drafting style and in efforts to simplify the standard Redrafted ISA 315 consists of 4 pages of definitions (2 in ED), 5 pages requirements (8 in ED), and 54 pages application material (60 in ED). The application material is still being re-ordered and drafted with some material likely to move to the appendices.
14. Redrafted ISA 315 includes:
  - Appendix 1: Considerations for Understanding the Entity and its Business Model
  - Appendix 2: Understanding the Inherent Risk Factors
  - Appendix 3: Understanding the Entity’s System of Internal Control
  - Appendix 4: Considerations for Understanding Internal Audit
  - Appendix 5: Considerations for Understanding Information Technology
  - Appendix 6: Considerations for Understanding General IT Controls
  - Flowcharts – updated for the new requirements
15. The ISA 315 Task Force are also developing guidance to assist with implementation:

- First time implementation guide – new and revised concepts
- Frequently asked questions

**Actions for the AUASB**

1. Review Table 1 (below) and consider if you agree with how matters raised in our submission have been addressed. Consider the questions included in this table shaded in grey.
2. Read redrafted ISA 315 (ISA 315 Full standard revised clean) – definitions and requirements. Application material has been provided to assist however note this has not been finalised. Consider:
  - (a) Do you think the new drafting style assists with the complexity and overall understandability of the standard?
  - (b) Do you have any concerns in relation to moving content from the requirements to the definitions and if this decreases the robustness of the standard?
  - (c) Do you agree with the requirements?
  - (d) Do you have any other matters to raise?

**Table 1: Reconciliation of the AUASB submission to the updated ISA 315**

Matters raised in the ED 315 submission by the AUASB	How the matters are addressed in redrafted ISA 315
<p><u>Complexity and length of standard</u></p> <ul style="list-style-type: none"> <li>• The increased length of ED 315 is a potential barrier to its understandability and consistent application.</li> <li>• Consider drafting standards for less complex entities, then adding application or guidance for more complex entities.</li> <li>• The introduction of many new definitions and concepts, or the distinction between concepts, add complexity to the standard.</li> <li>• Reassess whether some content currently in the application material of ED 315 should instead be included in other non-authoritative guidance.</li> </ul>	<p>Addressed through new drafting style as well as simplifying requirements and removing set up or sign post requirements.</p>
<p>Definition “significant classes of transactions, account balances and disclosures” and “relevant assertions”.</p> <p>We consider that the term “more than remote” is fundamentally different to “a reasonable possibility”, and this revised definition may result in more significant classes of transactions, account balances, or disclosures being identified than was intended.</p>	<ul style="list-style-type: none"> <li>• Concern has been addressed the definitions are now: <ul style="list-style-type: none"> <li>○ Significant class of transaction, account balance or disclosure – A class of transactions, account balance or disclosure for which there is one or more relevant assertion.</li> <li>○ Relevant assertions – An assertion about a class of transactions, account balance or disclosure is relevant when it has an identified risk of material misstatement. The determination of whether an assertion is a relevant assertion is made before consideration of controls.”</li> </ul> </li> <li>• The ED 315 Task Force have been considering how to link the threshold to an identified risk of material misstatement to a concept already existing in the ISAs, and have proposed the following amendment to ISA 200: <p><u>New Definitions: Risk of Material Misstatement (Ref: Para. 13(n)) A15a.</u></p> <p><u>In determining identified risks of material misstatement, the auditor considers those risks for which a misstatement could be material, and the likelihood that the risk could occur (i.e., whether there is a reasonable possibility that the risk could occur). If there are risks that could result in a material misstatement and have a reasonable possibility of occurrence and that have not been addressed by the auditor’s procedures, then audit risk is not at an acceptably low level. The auditor’s</u></p> </li> </ul>

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**Table 1: Reconciliation of the AUASB submission to the updated ISA 315**

Matters raised in the ED 315 submission by the AUASB	How the matters are addressed in redrafted ISA 315
	<p><u>judgment is necessary to identify which risks are identified risks of material.</u></p> <div style="border: 1px solid black; padding: 5px; margin: 10px 0;"> <p>Question for the AUASB</p> <p>Does the AUASB agree with this proposed amendment to ISA 200?</p> </div>
<p><u>Inherent risk factors (IRF)</u></p> <ul style="list-style-type: none"> <li>• Supportive of the concepts and definition. But consider it is overly complicated by having a requirement to explicitly take into account IRF.</li> <li>• Insufficient clarity in how to apply the concepts and definitions of the IRF and the current proposed definition of significant risk.</li> <li>• Inclusion of quantitative is potentially problematic.</li> </ul>	<p>Matters partly addressed. Appendix 2 Understanding the IRF has been developed for inclusion in ISA 315 to assist.</p> <ul style="list-style-type: none"> <li>• IRF are now included in the required understanding of the entity and its environment, because it is at this stage that the auditor will consider the events and conditions to which the inherent risk factors relate. (paragraph 23) The related application material has also been enhanced to explain how the inherent risk factors are considered when the auditor obtains an understanding about how the applicable financial reporting framework is applied, giving rise to the auditor’s understanding about whether classes of transactions, account balances or disclosures are subject to, or affected by, the inherent risk factors</li> <li>• IRF maintained in the requirement to assess inherent risk, and definition of significant risk.</li> <li>• Definition of IRF still includes “quantitative” however as the definition of significant has been changed from “likelihood or magnitude” to likelihood and magnitude”, this is no longer problematic.</li> </ul>
<p><u>Definition of significant risk and the spectrum of inherent risk</u></p> <ul style="list-style-type: none"> <li>• More detail required on the spectrum of inherent risk i.e. how to assess where on the spectrum a risk resides</li> <li>• Definition of significant risk should be “likelihood <u>and</u> magnitude” as opposed to the current “likelihood <u>or</u> magnitude”.</li> <li>• The definition of significant risk should be amended to those “at the upper end of the spectrum of inherent risk” and not “close to the upper end of the spectrum of inherent risk”.</li> </ul>	<p>Matters partly addressed however more explanatory and appendix to assist with concepts.</p> <ul style="list-style-type: none"> <li>• Concept of spectrum of inherent risk is retained and guidance on how to assess where on the spectrum a risk would reside with illustrations.</li> <li>• Changed the definition of significant risk to “likelihood of misstatement occurring <u>and</u> the magnitude of potential misstatement”.</li> <li>• Definition of significant risk retained as “close to the upper end of the spectrum of inherent risk”</li> <li>• Cautious about adding too much application material on how to assess on the spectrum as this requires professional judgement. Will add application material to clarify that: <ul style="list-style-type: none"> <li>• in rare circumstances there may be an entity that does not have a significant risk</li> <li>• routine, non-complex transactions are not likely to give risk to significant risk when they do not involve subjectivity (eg</li> </ul> </li> </ul>

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<b>Table 1: Reconciliation of the AUASB submission to the updated ISA 315</b>	
<b>Matters raised in the ED 315 submission by the AUASB</b>	<b>How the matters are addressed in redrafted ISA 315</b>
	<p>trade receivables unlikely to be a SR but the valuation could be).</p> <p>In summary the AUASB’s concerns have been considered and addressed except for the third point as the “close to” is proposed to be retained.</p>
<p><u>Flowcharts</u></p> <ul style="list-style-type: none"> <li>• Supportive of being in appendices</li> <li>• Suggest they could be further enhanced to better present and emphasise the iterative and non-linear processes contained within the proposed standard</li> </ul>	<p>Have been simplified based on the updated standard. Will be in appendices.</p>
<p><u>Introductory paragraphs</u></p> <ul style="list-style-type: none"> <li>• Supportive</li> <li>• Paragraphs 4 and 5 – repetitive</li> <li>• The “spectrum of inherent risk” needs to be described in greater detail by including how a practitioner may assess at which point a risk resides on the spectrum, or alternatively referring to where this concept is specifically explained in the application material.</li> </ul>	<p><i>Still to be updated. To be reviewed by the AUASB at its September 2019 meeting.</i></p>

**Table 1: Reconciliation of the AUASB submission to the updated ISA 315**

<b>Matters raised in the ED 315 submission by the AUASB</b>	<b>How the matters are addressed in redrafted ISA 315</b>
<p><u>Scalability</u></p> <ul style="list-style-type: none"> <li>• Overall concern ED 315 is not scalable to smaller and medium entities.</li> <li>• Terminology used in ED 315 should refer to “less complex entities”.</li> <li>• Recommend guidance and examples be included in the application material of the proposed standard on how to effectively scale the work effort in ED 315 to less complex entities, such as examples of: how to perform risk identification and assessment procedures for a less complex entity where a mainly substantive audit approach will be adopted; and how to perform risk identification and assessment procedures when the entity’s system of internal control may be less detailed and formalised.</li> </ul>	<p>A main focus of the Task Force.</p> <p>Terminology has been changed and the application material includes “Scalability paragraphs”</p>
<p><u>Automated tools and techniques</u></p> <ul style="list-style-type: none"> <li>• Agree with the approach taken of using examples to illustrate how automated tools and techniques may be used in risk assessment.</li> <li>• ED 315 could be further enhanced by addressing: <ul style="list-style-type: none"> <li>○ How automated tools and techniques may be used for risk assessment, and how they meet or impact the requirements of ED 315. This is to avoid automated tools and techniques being</li> </ul> </li> </ul>	<p><i>Still to be updated. To be reviewed by the AUASB at its September 2019 meeting..</i></p>

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**Table 1: Reconciliation of the AUASB submission to the updated ISA 315**

Matters raised in the ED 315 submission by the AUASB	How the matters are addressed in redrafted ISA 315
<p>applied in addition to the current requirements.</p> <ul style="list-style-type: none"> <li>○ What are the requirements in relation to understanding and/or obtaining evidence over the reliability of underlying data (information produced by the entity) used within automated tools and techniques that are used for risk assessment (including the nature, timing and extent of testing).</li> <li>○ Risk factors relating to the use of big data and automated analytics technology.</li> </ul> <ul style="list-style-type: none"> <li>● Other specific suggestions raised</li> </ul>	
<p><u>Professional scepticism</u></p> <ul style="list-style-type: none"> <li>● Supportive of the principle of obtaining an appropriate base of evidence for risk assessment, however we do not support using the term “sufficient appropriate audit evidence”</li> </ul>	<p>Matter addressed. The term “sufficient appropriate audit evidence” has been removed and the following requirements (underlined) added specifically to address:</p> <p>(17) The auditor shall <u>design and perform risk assessment procedures to obtain audit evidence that provides an appropriate basis for: (a) The identification and assessment of risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels; and (b) The design of further audit procedures in accordance with ISA 330.</u></p> <p>[New] <u>The auditor shall design and perform risk assessment procedures in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory.</u></p> <p>[New] 51A. <u>The auditor shall evaluate whether the audit evidence obtained from the risk assessment procedures provides an appropriate basis for the identification and assessment of the risks of material misstatement at the financial statement and assertion level, and the design of further audit procedures. In identifying and assessing the risks of material misstatement, the auditor shall take</u></p>

**Table 1: Reconciliation of the AUASB submission to the updated ISA 315**

Matters raised in the ED 315 submission by the AUASB	How the matters are addressed in redrafted ISA 315
	<p><u>into account all audit evidence relevant to risk assessment procedures, whether corroborative or contradictory</u></p> <p>The following has been removed from requirements and added to application material:</p> <p>Inquiry alone is not sufficient for this purpose. Risk assessment procedures by themselves do not provide sufficient appropriate audit evidence on which to base the audit opinion. This has been moved to application material – see paragraph A141c.</p>
<p><u>Internal controls</u></p> <ul style="list-style-type: none"> <li>• It is not sufficiently clear how controls including the understanding obtained over the system of internal control, impact the identification of risks of material misstatement.</li> <li>• Clarify the design and implementation testing required verses gaining an understanding.</li> <li>• More guidance on which controls reside in the Information System and Communication component as distinct from the Control Activities component, and the difference, if any, on the requirements in relation to the audit procedures to be performed on these controls.</li> <li>• Controls relevant to the audit – clarify the intention of 39(e).</li> <li>• Some of our stakeholders have expressed concern that for some less complex entities the controls over journals may not be documented and are difficult to test.</li> </ul>	<p>The ATG consider these points have been addressed and updated ISA 315 much clearer. Refer to question below</p> <ul style="list-style-type: none"> <li>• The requirement to ‘obtain an understanding’ of each component of internal control has been deleted. Rather, a broad requirement to obtain an understanding of the relevant aspects of the components of the entity’s system of internal control has been combined with the requirement to obtain an understanding of the entity and its environment, and the applicable financial reporting framework/ Application material explains that the understanding is obtained by focusing on the relevant aspects of each component, with the relevant aspects that are required to be understood for each component now in the definitions.</li> <li>• The evaluations for each of the components have been kept separate (however, the entity’s process to monitor the system of internal control and the entity’s risk assessment process have been combined as they are similar in nature). Application material has been added to make clear that the broader term “understanding” means to obtain an understanding of the relevant aspects of that component (implicitly referring to the definition which contains the ‘relevant aspects’ to be understood) AND to perform the evaluation of the component as set out in each section. It is this ‘understanding’ that provides the basis for the identification and assessment of the risks of material misstatement.</li> <li>• The evaluation of the information system and communication component has been amended to distinguish this evaluation from that required from the evaluation required for controls in the control activities component (i.e., evaluating whether the policies that define information processing activities in the entity’s information system appropriately support the preparation of the financial statements versus evaluating whether identified controls in the control activities component are designed effectively and determining their implementation (D&amp;I)).</li> <li>• The requirement for D&amp;I has been simplified to apply to the identified controls in the control activities component,</li> </ul>



**Table 1: Reconciliation of the AUASB submission to the updated ISA 315**

Matters raised in the ED 315 submission by the AUASB	How the matters are addressed in redrafted ISA 315
	<p>including GITCs, so that it is clear for which controls D&amp;I is required.</p> <ul style="list-style-type: none"> <li>Paragraph 39 Controls relevant to the audit have contained to “the control activities component”. Paragraph 39 e in ED 315 has been changed to paragraph 39 c to:</li> </ul> <p>Controls that are necessary for the auditor to identify to achieve the objectives in paragraph 17(a) and (b) because of where the assessments of the related risks of material misstatement at the assertion level fall on the spectrum of inherent risk;</p> <div style="border: 1px solid black; padding: 5px; margin: 10px 0;"> <p>Question for the AUASB</p> <p>Do you agree with the change to paragraph 39, specifically 39 c – is it clear what would be captured here?</p> </div>
<p><u>Information Technology</u></p> <ul style="list-style-type: none"> <li>Support the introduction of the new IT-related concepts and definitions.</li> <li>Could be enhanced by including the risk factors relating to current and evolving technology which connect to organizational networks, such as infrastructure / software as a service solutions, wireless networks, blockchain, and other technology devices that connect to organisational networks.</li> </ul>	<p>Have modernised and added new definitions. Redrafted ISA 315 paragraph 40 requires the identification of the risks arising from IT and defined below.</p> <p><i>[New] Risks arising from IT</i> – Susceptibility of information processing controls to ineffective design or operation, or risks to the integrity of the entity’s information in the entity’s information system, due to the ineffective design or operation of the entity’s IT processes (see IT environment).</p> <p><i>General IT controls</i>- Control activities that support the continued proper operation of the IT environment, including the continued effective functioning of information processing controls and the integrity of information (i.e. the completeness, accuracy and validity of information) in the entity’s information system. General IT controls are controls over the entity’s IT processes. Also see the definition of IT environment.</p> <p><i>Information processing controls</i> (new term for application controls) - Control activities that directly support the actions to mitigate transactions and information processing risks in the entity’s information system. They may operate at the assertion level or may support the operation of other control activities at the assertion level. The objectives of information processing controls are to maintain the completeness, accuracy and validity of transactions and other information throughout processing. Such controls may be automated or manual and may rely on information or other controls, including other information processing controls that maintain the integrity of information.</p>

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<p><u>Separate inherent and control risk assessment</u></p> <ul style="list-style-type: none"> <li>• Support the separate assessments of inherent and control risk at the assertion level.</li> <li>• Support assessing control risk at maximum if not testing operating effectiveness.</li> <li>• The current use of the singular term (“risks of material misstatement”) both before and after the separate assessment of inherent risk and control risk is confusing.</li> <li>• Provide additional detail on how to assess control risk at various levels of the spectrum of risk.</li> <li>• Describing in greater granularity in ED 315 the process the auditor undertakes to combine their separate inherent and control risk assessments.</li> </ul>	<ul style="list-style-type: none"> <li>• The requirement to identify risks of material misstatement has been simplified to make clear what needs to be identified and removing the “how.”</li> <li>• The identification and assessment of ROMM has been simplified and doesn’t include the how.</li> <li>• The order for determining the relevant assertions and significant classes of transactions, account balances and disclosures has been reversed and is after the identification of ROMM</li> <li>• The inherent risk factors have been deleted from the identification of the risks of material misstatement at the assertion level, and only presented as part of the assessment of the risks of material misstatement at the assertion level,</li> <li>• To address the concerns about assessing control risk at maximum when the auditor has no intention to test the operating effectiveness of controls, the Task Force has proposed that the requirement to assess control risk is conditional on the auditor’s intent to test the operating effectiveness of controls. If there is no such intention, the assessment of the risks of material misstatement is based on inherent risk (i.e., control risk is not taken into account). This would therefore eliminate the need to assess control risk at the “maximum.” The related application material has been amended accordingly.</li> </ul>
<p><u>Financial Statement Risks</u></p> <ul style="list-style-type: none"> <li>• Supportive however need clarity / examples of how they may affect the assessment of risks at the assertion level.</li> <li>• Include in introductory paragraphs</li> </ul>	<p>Not addressed at this stage</p>
<p><u>Stand back and ISA 330 para 18</u></p> <ul style="list-style-type: none"> <li>• Supportive of a standback in 315 but don’t need both</li> <li>• Reconsider if the terms “quantitatively and qualitatively” are necessary in ISA 315</li> </ul>	<p>The stand back provision retained in both 315 and 330. The references to qualitative and quantitative in the context of materiality have removed.</p> <p>ED 315 Paragraph 53 proposed to read:</p> <p>For material classes of transactions, account balances or disclosures that have not been identified as significant classes of transactions, account balances or disclosures the auditor shall evaluate whether the auditor’s conclusion that there are no related risks of material misstatement remains appropriate.</p>

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<b>Table 1: Reconciliation of the AUASB submission to the updated ISA 315</b>			
<b>Matters raised in the ED 315 submission by the AUASB</b>	<b>How the matters are addressed in redrafted ISA 315</b>		
	330 para 18 to remain as it is and application material to make it clear that the auditor would consider the most appropriate assertion when designing substantive audit procedures.		
	<table border="1"> <tr> <td>Question for the IAASB</td> </tr> <tr> <td>Do you agree with paragraph 53?</td> </tr> </table>	Question for the IAASB	Do you agree with paragraph 53?
Question for the IAASB			
Do you agree with paragraph 53?			

16. Other matters raised by the AUASB and not included in the IAASB summary

The AUASB’s submission included that the public sector considerations had not been appropriately considered. If this is not addressed in the final standard, the AUASB can consider if additional Australian guidance is required. The public sector matters have not been updated in the

**Material Presented**

Agenda Item 2.1.0

ED 315 AUASB Board Meeting Summary Paper

Agenda Item 2.1.1

IAASB ED 315 Agenda Item 2F – ISA 315 Full standard revised clean

**ISA 315 (Revised)<sup>1</sup>**

This paper sets out the definitions, requirements, application material and appendices presented in clean, for informational purposes only.

**Definitions**

16. For purposes of the ISAs, the following terms have the meanings attributed below:

- (a) [*Moved*]
- (b) *Assertions* – Representations, explicit or otherwise, with respect to the recognition, measurement, presentation and disclosure of information in the financial statements which are inherent in management representing that the financial statements are prepared in accordance with the applicable financial reporting framework. Assertions are used by the auditor to consider the different types of potential misstatements that may occur when identifying, assessing and in responding to the risks of material misstatement. (Ref. Para: A1–A2).
- (c) *Business risk* – A risk resulting from significant conditions, events, circumstances, actions or inactions that could adversely affect an entity’s ability to achieve its objectives and execute its strategies, or from the setting of inappropriate objectives and strategies.
- (ca) *Control activities* – The entity’s procedures to implement its policies that relate to the other components of the entity’s system of internal control. (Ref. Para: A2a)
- (d) *Controls* – Policies or procedures that are embedded within the components of the system of internal control to achieve the control objectives of management or those charged with governance. In this context:
  - (i) Policies are statements of what should, or should not, be done within the entity to effect control. Such statements may be documented, explicitly stated in communications, or implied through actions and decisions.
  - (ii) Procedures are actions to implement policies. (Ref: Para. A3–A4)
- (e) *General information technology (IT) controls* – Control activities that support the continued proper operation of the IT environment, including the continued effective functioning of information processing controls and the integrity of information (i.e. the completeness, accuracy and validity of information) in the entity’s information system. General IT controls are controls over the entity’s IT processes. Also see the definition of *IT environment*.

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<sup>1</sup> Proposed ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement* (ED-315)

- (ea) *Information processing controls* – Control activities that directly support the actions to mitigate transactions and information processing risks in the entity’s information system. They may operate at the assertion level or may support the operation of other control activities at the assertion level. The objectives of information processing controls are to maintain the completeness, accuracy and validity of transactions and other information throughout processing. Such controls may be automated or manual and may rely on information or other controls, including other information processing controls that maintain the integrity of information.
- (f) *Inherent risk factors* – Characteristics of events or conditions that affect susceptibility to misstatement of an assertion about a class of transactions, account balance or disclosure, before consideration of controls. Such factors may be qualitative or quantitative, and include complexity, subjectivity, change, uncertainty or susceptibility to misstatement due to management bias or misappropriation of assets. (Ref: Para. A5–A6)
- (g) *IT environment* – The IT applications and supporting IT infrastructure, as well as the IT processes and personnel involved in those processes, that an entity uses to support business operations and achieve business strategies. For the purposes of this ISA:
  - (i) An IT application is a program or a set of programs that is used in the initiation, processing, recording and reporting of transactions or information. IT applications include data warehouses or report writers.
  - (ii) The IT infrastructure comprises the network, operating systems, and databases and their related hardware and software.
  - (iii) The IT processes are the entity’s processes to manage access to the IT environment, manage program changes or changes to the IT environment and manage IT operations.
- (ga) *Other relevant sources of audit evidence* — Information that is relevant to identifying and assessing risks of material misstatement from:
  - (i) The auditor’s acceptance or continuance of the client relationship or the audit engagement;
  - (ii) Other engagements performed by the engagement partner for the entity, where applicable.
- (gb) *Relevant aspects of the control environment* – The set of controls, processes and structures that address:
  - (i) How management’s oversight responsibilities are carried out, such as the entity’s culture and management’s commitment to integrity and ethical values;
  - (ii) When those charged with governance are separate from management, the independence of, and oversight over the entity’s system of internal control by, those charged with governance;
  - (iii) The entity’s assignment of authority and responsibility;
  - (iv) How the entity attracts, develops, and retains competent individuals; and

- (v) How the entity holds individuals accountable for their responsibilities in the pursuit of the objectives of the system of internal control.
- (gc) *Relevant aspects of the entity and its environment* – These comprise:
  - (i) The entity’s organizational structure, ownership and governance, and its business model, including the extent to which the business model integrates the use of IT;
  - (ii) Industry, regulatory and other external factors; and
  - (iii) The measures used, internally and externally, to assess the entity’s financial performance.
- (gd) *Relevant aspects of the entity’s process to monitor the system of internal control* – Those aspects of the entity’s process that address:
  - (i) Ongoing and separate evaluations for monitoring the effectiveness of controls, and the identification and remediation of control deficiencies identified; and
  - (ii) The entity’s internal audit function, if any, including its nature, responsibilities and activities.
- (ge) *Relevant aspects of the entity’s risk assessment process* – Those aspects of the entity’s process that address:
  - (i) Identifying business risks relevant to financial reporting objectives;
  - (ii) Assessing the significance of those risks, including the likelihood of their occurrence; and
  - (iii) Addressing those risks.
- (gf) *Relevant aspects of the information system and communication*

*Relevant aspects of the information system* – The entity’s information processing activities, including its data and information, the resources to be used in such activities and the policies that define, for significant classes of transactions, account balances and disclosures:

  - (i) How information flows through the entity’s information system, including how:
    - a. Transactions are initiated, and how information about them is recorded, processed, corrected as necessary, and incorporated in the general ledger and reported in the financial statements; and
    - b. Information about events and conditions, other than transactions, is captured, processed and disclosed in the financial statements.
  - (ii) The accounting records, specific accounts in the financial statements and other supporting records relating to the flows of information in the information system;
  - (iii) The financial reporting process used to prepare the entity’s financial statements, including disclosures; and
  - (iv) The entity’s resources, including the IT environment, relevant to (i)–(iii) above. (Ref: Para. A8a)

*Relevant aspects of communication* – Communications in relation to significant matters that support the preparation of the financial statements and other reporting responsibilities in the information system and other components of the system of internal control:

- (i) Between people within the entity, including how financial reporting roles and responsibilities are communicated;
  - (ii) Between management and those charged with governance; and
  - (iii) With external parties, such as those with regulatory authorities.
- (h) *Relevant assertions* – An assertion about a class of transactions, account balance or disclosure is relevant when it has an identified risk of material misstatement. The determination of whether an assertion is a relevant assertion is made before consideration of controls. (Ref: Para. A9)
- (ha) *Risks arising from IT* – Susceptibility of information processing controls to ineffective design or operation, or risks to the integrity of the entity’s information in the entity’s information system, due to the ineffective design or operation of the entity’s IT processes (see IT environment).
- (i) *Risk assessment procedures* – The audit procedures designed and performed to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.
- (j) *Significant class of transactions, account balance or disclosure* – A class of transactions, account balance or disclosure for which there is one or more relevant assertions.
- (k) *Significant risk* – An identified risk of material misstatement:
- (i) For which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk due to the degree to which one or a combination of the inherent risk factors affect the likelihood of a misstatement occurring and the magnitude of potential misstatement should that misstatement occur; or
  - (ii) That is to be treated as a significant risk in accordance with the requirements of other ISAs.<sup>2</sup> (Ref: Para. A10)
- (l) *System of Internal Control* – The system designed, implemented and maintained by those charged with governance, management and other personnel, to provide reasonable assurance about the achievement of an entity’s objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. For the purposes of the ISAs, the system of internal control consists of five inter-related components:
- (i) Control environment.
  - (ii) The entity’s risk assessment process.
  - (iii) The entity’s process to monitor the system of internal control.
  - (iv) The information system and communication.
  - (v) Control activities.

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<sup>2</sup> ISA 240, *The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraph 27 and ISA 550, *Related Parties*, paragraph 18

## Requirements

### Risk Assessment Procedures and Related Activities

17. The auditor shall design and perform **risk assessment procedures** to obtain audit evidence that provides an appropriate basis for: (Ref: Para. A11a–A16d)
- (a) The identification and assessment of risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels; and
  - (b) The design of further audit procedures in accordance with ISA 330.
- The auditor shall design and perform risk assessment procedures in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory.
18. The risk assessment procedures shall include the following: (Ref: Para. A17–A20b)
- (a) Inquiries of management and of other appropriate individuals within the entity (Ref: Para. A21–A29)
  - (b) Analytical procedures. (Ref: Para. A30–A34a)
  - (c) Observation and inspection. (Ref: Para. A35–A36)

### *Other Relevant Sources of Audit Evidence*

19. In obtaining audit evidence in accordance with paragraph 17, the auditor shall consider **other relevant sources of audit evidence**. (Ref: Para. A37–A38)
20. *[Moved]*

### *Information from the Auditor's Previous Experience with the Entity and Previous Audits* (Ref: Para. A39–A40)

21. Where the auditor intends to use information obtained from the auditor's previous experience with the entity and from audit procedures performed in previous audits, the auditor shall evaluate whether such information remains relevant and reliable as audit evidence for the current audit.

### *Engagement Team Discussion* (Ref: Para. A40a–A46)

22. The engagement partner and other key engagement team members shall discuss the application of the applicable financial reporting framework and the susceptibility of the entity's financial statements to material misstatement.
- 22A. When there are engagement team members not involved in the engagement team discussion, the engagement partner shall determine which matters are to be communicated to those members.



## Obtaining an Understanding of the Entity and its Environment, the Applicable Financial Reporting Framework and the Entity’s System of Internal Control

23. The auditor shall obtain an understanding of relevant aspects of: (Ref: Para. A47–A47h)
- (a) The **entity and its environment**, including how events and conditions are subject to, or affected by, the **inherent risk factors**; (Ref: Para. A48–A78)
  - (b) The applicable financial reporting framework, including the entity’s accounting policies and the reasons for any changes thereto; (Ref: Para. A78a–A88) and
  - (c) The components of the entity’s **system of internal control**. (Ref: Para. A89–A104)

### *Applicable Financial Reporting Framework*

24. The auditor shall evaluate whether the entity’s accounting policies are appropriate and consistent with the applicable financial reporting framework.

### *Understanding the Relevant Aspects of the Components of the Entity’s System of Internal Control*

25. *[Moved]*

26. *[Deleted]*

Control Environment, the Entity’s Risk Assessment Process and the Entity’s Process to Monitor the System of Internal Control (Ref: Para. A104a–A104d)

27. *[Moved]*

28. The auditor shall evaluate the relevant aspects of the **control environment** by determining whether: (Ref: Para. A105–A114a)
- (a) Management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behavior;
  - (b) The control environment provides an appropriate foundation for the other components of the system of internal control; and
  - (c) Control deficiencies undermine the other components of the system of internal control.

29. *[Moved]*

30. The auditor shall evaluate whether the relevant aspects of **the entity’s risk assessment process** and the relevant aspects of **the entity’s process to monitor the system of internal control** are appropriate. (Ref: Para. A117–A120 and Para. A123–A128a; Para. A131–A135a)

31. If the auditor identifies risks of material misstatement that management failed to identify, the auditor shall obtain an understanding of why the entity’s risk assessment process failed to identify such risks of material misstatement.

32. *[Moved]*

33. The auditor shall obtain an understanding of the sources of the information used in the entity’s process to monitor the system of internal control, and the basis upon which management considers the information to be sufficiently reliable for the purpose. (Ref: Para. A129–A130)

34. [Moved]

Information System and Communication, and Control Activities (Ref: Para. A135b–A135h)

35. [Moved]

36. The auditor shall evaluate whether the relevant aspects of the entity's **information system and communication** appropriately support the preparation of the entity's financial statements in accordance with the applicable financial reporting framework. (Ref: Para. A135i–A159)

37. [Moved]

38. [Deleted]

39. The auditor shall identify **controls** that address risks of material misstatement at the assertion level in the **control activities** component, as follows: (Ref: Para. A160–A179)

- (a) Controls that address risks that are identified as a significant risk; (Ref: Para. A169–A173)
- (b) Controls over journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments; (Ref: Para. A174–A175a)
- (c) Controls that are necessary for the auditor to identify to achieve the objectives in paragraph 17(a) and (b) because of where the assessments of the related risks of material misstatement at the assertion level fall on the spectrum of inherent risk; (Ref: Para. A175b–A175c) and
- (d) Controls for which the auditor plans to test operating effectiveness in determining the nature, timing and extent of substantive testing, which shall include controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence. (Ref: Para. A175d–A178)

40. Based on controls identified, the auditor shall identify the IT applications and the other aspects of the entity's IT environment that are subject to **risks arising from the use of IT**. For such IT applications and other aspects of the **IT environment**, the auditor shall identify: (Ref: Para. A179a–A193)

- (a) The related risks arising from the use of IT; and
- (b) The entity's **general IT controls** that address such risks.

41. [Moved]

42. For each control identified in the control activities component the auditor shall: (Ref: Para. A194–A200)

- (a) Evaluate whether the control is designed effectively to address the risk of material misstatement at the assertion level, or effectively designed to support the operation of other controls; and
- (b) Determine whether the control has been implemented by performing procedures in addition to inquiry of the entity's personnel.

*Control Deficiencies Within the System of Internal Control* (Ref: Para. A200a–A200c)

43. Based on the auditor's evaluation of each of the components of the entity's system of internal control, the auditor shall determine whether one or more control deficiencies have been identified.

44. [Deleted]

### Identifying and Assessing the Risks of Material Misstatement

45. The auditor shall identify the risks of material misstatement and determine whether they exist at: (Ref: Para. A201–A202a and A206a–A206c)
- (a) The financial statement level; (Ref: Para. A207–A207d) or
  - (b) The assertion level for classes of transactions, account balances, and disclosures. (Ref: Para. A202b–A206 and A208–A210)
46. The auditor shall determine the **relevant assertions** and the **significant classes of transactions, account balances and disclosures**. (Ref: Para. A211–A214)

#### *Assessing Risks of Material Misstatement at the Financial Statement Level*

47. The auditor shall assess the identified risks of material misstatement at the financial statement level. For each risk identified at the financial statement level, the auditor shall: (Ref: Para. A215–A220)
- (a) Determine whether such risks affect the assessment of risks at the assertion level; and
  - (b) Evaluate the nature and extent of their pervasive effect on the financial statements.

#### *Assessing Risks of Material Misstatement at the Assertion Level*

##### Assessing Inherent Risk

48. For identified risks of material misstatement at the assertion level, the auditor shall assess inherent risk by assessing the likelihood and magnitude of material misstatement. In doing so, the auditor shall take into account how, and the degree to which: (Ref: Para. A220a–A228)
- (a) Identified events and conditions relating to significant classes of transactions, account balances and disclosures are subject to, or affected by, the inherent risk factors.
  - (b) The risks of material misstatement at the financial statement level affect the assessment of inherent risk for risks of material misstatement at the assertion level.
49. The auditor shall determine whether any of the assessed risks of material misstatement are **significant risks**. (Ref: Para. A228a–A231)
50. The auditor shall determine, for any of the risks of material misstatement at the assertion level, whether substantive procedures alone cannot provide sufficient appropriate audit evidence. (Ref: Para. A231a–A231f)

##### Assessing Control Risk

51. If the auditor plans to test the operating effectiveness of controls, the auditor shall assess control risk. If the auditor does not intend to test the operating effectiveness of controls, the assessment of the risk of material misstatement is based on inherent risk. (Ref: Para. A232–A235a)

#### *Evaluating the Audit Evidence Obtained from the Risk Assessment Procedures*

- 51A. The auditor shall evaluate whether the audit evidence obtained from the risk assessment procedures provides an appropriate basis for the identification and assessment of the risks of material misstatement at the financial statement and assertion level, and the design of further audit

procedures. In identifying and assessing the risks of material misstatement, the auditor shall take into account all audit evidence relevant to risk assessment procedures, whether corroborative or contradictory. (Ref: Para. A239a–A239b)

*Classes of Transactions, Account Balances and Disclosures that are Not Significant, but which are Material*

52. For material classes of transactions, account balances or disclosures that have not been identified as significant classes of transactions, account balances or disclosures, the auditor shall evaluate whether the auditor's conclusion that there are no related risks of material misstatement remains appropriate. (Ref: Para. A240–A242)

*Revision of Risk Assessment*

53. If the auditor obtains new information which is inconsistent with the audit evidence on which the auditor originally based the identification and assessments of the risks of material misstatement, the auditor shall revise the assessment. (Ref: Para. A243)

**Documentation**

54. The auditor shall include in the audit documentation:<sup>3</sup> (Ref: Para. A244–A247)
- (a) The discussion among the engagement team and the significant decisions reached;
  - (b) Key elements of the auditor's understanding in accordance with paragraph 23; the sources of information from which the auditor's understanding was obtained; and the risk assessment procedures performed;
  - (c) The controls identified in accordance with the requirements in paragraphs 39 and 40.
  - (d) The identified and assessed risks of material misstatement at the financial statement level and at the assertion level, including significant risks, and the rationale for the significant judgments made.

**Application and Other Explanatory Material**

**Definitions**

*Assertions* (Ref: Para. 16(b))

- A1. Representations by management with respect to the recognition, measurement, presentation and disclosure of information in the financial statements of classes of transactions, account balances and disclosures differ from written representations provided to the auditor by management, as required by ISA 580,<sup>4</sup> to confirm certain matters or support other audit evidence.
- A2. Assertions that the auditor may use in addressing the requirements of this ISA are further described in paragraph A204.

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<sup>3</sup> ISA 230, *Audit Documentation*, paragraphs 8–11, and A6–A7

<sup>4</sup> ISA 580, *Written Representations*

*Control Activities* (Ref: Para. 16(ca))

A2a. Control activities include direct controls and indirect controls. Direct controls are controls that are precise enough to address risks of material misstatement at the assertion level. Indirect controls are controls that are not sufficiently precise to prevent, detect or correct misstatements at the assertion level but which may have an indirect effect on the likelihood that a misstatement will be detected or prevented on a timely basis.

*Controls* (Ref: Para. 16(d))

- A3. Policies are implemented through the actions of personnel within the entity, or through their restraint from taking actions that would conflict with such policies.
- A4. Procedures may be mandated, through formal documentation or other communication by management or those charged with governance, or may result from behaviors that are not mandated but are rather conditioned by the entity's culture. Procedures may be enforced through the actions permitted by the IT applications used by the entity or other aspects of the entity's IT environment.

*Inherent Risk Factors* (Ref: Para. 16(f))

A5. Inherent risk factors may be qualitative or quantitative and affect the susceptibility to misstatement of financial statement items. Qualitative inherent risk factors relating to the preparation of information required by the applicable financial reporting framework include:

- Complexity
- Subjectivity
- Change
- Uncertainty
- Susceptibility to misstatement due to management bias or misappropriation of assets.

A6. Other inherent risk factors, that affect susceptibility to misstatement of an assertion about a class of transactions, account balance or disclosure include:

- The quantitative or qualitative significance of the class of transactions, account balance or disclosure, and of the items in relation to performance materiality;
- The composition of the class of transactions, account balance or disclosure, including whether the items are subject to differing risks;
- The volume of activity and homogeneity of the individual transactions processed through the class of transactions or account balance or class of transactions, or reflected in the disclosure; or
- The existence of related party transactions in the class of transaction or account balance, or that are relevant to the disclosure.

A7. [*Moved to definition & Appendix 5*]

A8. [*Moved to Appendix 5*]

*Relevant Aspects of the Information System and Communication* (Ref: Para. 16(gf))

A8a. [Previously part of para. A139] Regardless of the size or nature of the entity, the information system includes relevant aspects of that system relates to information disclosed in the financial statements

*Relevant Assertions* (Ref: Para. 16(h))

A9. A risk of material misstatement may relate to more than one assertion, in which case all the assertions to which such a risk relates would be relevant assertions.

*Significant Risk* (Ref: Para. 16(k))

A10. Significance can be described as the relative importance of a matter, taken in context. The significance of a matter is judged by the auditor in the context in which the matter is being considered. The significance of a risk of material misstatement at the assertion level is considered in the context of the implications of the assessment of its inherent risk for the performance of the audit, including the nature, timing and extent of the auditor's further audit procedures and the persuasiveness of the audit evidence that will be required to reduce audit risk to an acceptable level. Significance can be considered in the context of how, and the degree to which, the susceptibility to misstatement is subject to, or affected by, the inherent risk factors, which affect the likelihood that a misstatement will occur, as well as the potential magnitude of the misstatement were that misstatement to occur.

A11. [Moved to **Appendix 3**]

**Risk Assessment Procedures and Related Activities (Ref: Para. 17–22A)**

Why Risk Assessment Procedures and Related Activities are Performed (Ref: Para. 17)

A11a. Information obtained by performing risk assessment procedures and related activities in accordance with paragraphs 17 to 22 of this ISA provides audit evidence that supports:

- The identification and assessment of the risks of material misstatement; and
- The design of further audit procedures in accordance with ISA 330.

A11b. The auditor may obtain audit evidence about classes of transactions, account balances and disclosures, and related assertions, and about the operating effectiveness of controls, even though risk assessment procedures were not specifically planned as substantive procedures or as tests of controls.

*Risk Assessment Procedures and Related Activities* (Ref: Para. 17)

A12. [Moved and partly deleted]

A13. The risks of material misstatement to be identified and assessed include both those due to fraud and those due to error, and both are covered by this ISA. However, the significance of fraud is such that further requirements and guidance are included in ISA 240 in relation to risk assessment procedures and related activities to obtain information that is used to identify the risks of material misstatement

due to fraud.<sup>5</sup> In addition, the following ISAs provide further requirements and guidance on identifying and assessing risks of material misstatement regarding specific matters or circumstances:

- ISA 540 (Revised)<sup>6</sup> in regard to accounting estimates;
- ISA 550<sup>7</sup> in regard to related party relationships and transactions;
- ISA 570 (Revised)<sup>8</sup> in regard to going concern; and
- ISA 600<sup>9</sup> in regard to group financial statements.

A14. [Moved]

A15. [Moved]

A15a. Professional skepticism is necessary for the critical assessment of audit evidence gathered when performing risk assessment procedures, and assists the auditor in remaining alert for possible indications of management bias. Professional skepticism is an attitude which is applied by the auditor when making professional judgments that then provides the basis for the auditor's actions. The auditor applies their professional judgment in determining when they have audit evidence that provides an appropriate basis for risk assessment, and is also applied in designing the auditor's responses to assessed risks of material misstatement.

A15b. Obtaining audit evidence from risk assessment procedures in an unbiased manner may involve obtaining evidence from multiple sources within and outside the entity. However, the auditor is not required to perform an exhaustive search to identify all possible sources of audit evidence.

A15c. The application of professional skepticism by the auditor may include:

- Questioning contradictory information and the reliability of documents;
- Considering responses to inquiries and other information obtained from management and those charged with governance;
- Being alert to conditions that may indicate possible misstatement due to error or fraud; and
- Considering whether audit evidence obtained supports the auditor's identification and assessment of the risks of material misstatement in light of the entity's nature and circumstances.

Scalability (Ref: Para. 17)

A16. The nature and extent of risk assessment procedures necessary to provide an appropriate basis for the risk identification and assessment and the design of further audit procedures will vary based on the nature (e.g., size and complexity) and circumstances of the entity (e.g., the formality of the entity's policies and procedures, and processes and systems). The auditor uses professional judgment to determine the nature and extent of the risk assessment procedures to be performed. The auditor's

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<sup>5</sup> ISA 240, paragraphs 12–24

<sup>6</sup> ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

<sup>7</sup> ISA 550, *Related Parties*

<sup>8</sup> ISA 570 (Revised), *Going Concern*

<sup>9</sup> ISA 600, *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*

primary consideration is whether the understanding that has been obtained meets the objective stated in this ISA.

A16a. Although the extent to which an entity's policies and procedures, and processes and systems are formalized may vary, the auditor is still required to obtain an understanding of that aspect.

Examples:

Some entities, including less complex entities, and particularly owner-managed entities, may not have established structured processes and systems, with limited documentation or irregularity in how the process is undertaken, such as the entity's risk assessment process or the entity's process to monitor the system of internal control. When such systems and processes lack formality, the auditor may still perform risk assessment procedures through observation and inquiry.

Other entities, typically larger, complex entities, are expected to have more formalized and documented policies and procedures. Accordingly, the auditor may use such documentation in performing risk assessment procedures.

A16b. The nature and extent of procedures to be performed the first time an engagement is undertaken may differ to subsequent periods for which the auditor already has a base knowledge and may therefore focus on changes that have occurred during the period.

*Sources of Information (Ref: Para. 17)*

Why Obtaining Information from Varying Sources is Important to Risk Assessment Procedures

A16c. Obtaining information from varying sources may provide potentially contradictory information, which may assist the auditor in exercising professional skepticism in identifying and assessing the risks of material misstatement.

A16d. Sources of information for risk assessment procedures may include:

- Information obtained through interactions with management, those charged with governance, and other key entity personnel, such as internal auditors.
- Information obtained directly or indirectly from certain external parties such as regulators.
- Other relevant sources of audit evidence, including the auditor's acceptance and continuance procedures and other engagements performed by the engagement partner for the entity.
- Information obtained from the auditor's previous experience with the entity and from audit procedures performed in previous audits, updated as appropriate.
- Publicly available information about the entity, for example entity-issued press releases, and materials for analysts or investor group meetings, analysts' reports or information about trading activity.

Regardless of the source of information, the auditor considers the relevance and reliability of the information to be used as audit evidence in accordance with ISA 500.<sup>10</sup>

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<sup>10</sup> ISA 500, paragraph 7



*Types of Risk Assessment Procedures (Ref: Para. 18)*

- A17. ISA 500<sup>11</sup> explains the types of audit procedures that may be performed in obtaining audit evidence from risk assessment procedures and further audit procedures. The nature, timing and extent of the audit procedures may be affected by the fact that some of the accounting data and other information may only be available in electronic form or only at certain points in time.<sup>12</sup>
- A18. Although the auditor is required to perform all the risk assessment procedures described in paragraph 18 in the course of obtaining the required understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control (see paragraphs 27–43), the auditor is not required to perform all of them for each aspect of that understanding. Other procedures may be performed where the information to be obtained therefrom may be helpful in identifying risks of material misstatement. Examples of such procedures may include making inquiries of the entity's external legal counsel or external supervisors, or of valuation experts that the entity has used.
- A19. [Moved]
- A20. [Moved]

Automated Tools and Techniques

- A20a. Through the use of technology, the auditor may perform risk assessment procedures on large volumes of data (from the general ledger, sub-ledgers or other operational data) including for analysis, recalculations, reperformance or reconciliations. Audit evidence obtained that supports the identification and assessment of risks of material misstatement, may also provide some audit evidence to support further audit procedures in accordance with ISA 330.
- A20b. The auditor may perform substantive procedures or tests of controls concurrently with risk assessment procedures because it is efficient to do so.

*Inquiries of Management and Others within the Entity (Ref: Para. 18(a))*

Why Inquiries are Made of Management and Others Within the Entity

- A21. Much of the information obtained by the auditor to support an appropriate basis for the identification and assessment of risks and the design of further audit procedures is obtained through inquiries of management and those responsible for financial reporting. Information may also be obtained by the auditor through inquiries of other appropriate individuals within the entity.
- A22. The auditor may also obtain information, or a different perspective for identifying and assessing risks of material misstatement through inquiries of others within the entity and other employees with different levels of authority.

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<sup>11</sup> ISA 500, *Audit Evidence*, paragraphs A14–A17 and A21–A25.

<sup>12</sup> ISA 500, paragraph A12

Examples:

- Inquiries directed towards those charged with governance may help the auditor understand the extent of oversight over the preparation of the financial statements by management. ISA 260 (Revised)<sup>13</sup> identifies the importance of effective two-way communication in assisting the auditor to obtain information from those charged with governance in this regard.
- Inquiries of employees responsible for initiating, processing or recording complex or unusual transactions may help the auditor to evaluate the appropriateness of the selection and application of certain accounting policies.
- Inquiries directed towards in-house legal counsel may provide information about such matters as litigation, compliance with laws and regulations, knowledge of fraud or suspected fraud affecting the entity, warranties, post-sales obligations, arrangements (such as joint ventures) with business partners and the meaning of contractual terms.
- Inquiries directed towards marketing or sales personnel may provide information about changes in the entity's marketing strategies, sales trends, or contractual arrangements with its customers.
- Inquiries directed about the risk management function (or inquiries of those performing such roles) may provide information about operational and regulatory risks that may affect financial reporting.
- Inquiries directed towards IT personnel may provide information about system changes, system or control failures, or other IT-related risks.

A23. [Deleted]

#### Considerations Specific to Public Sector Entities

A24. When making inquiries of those who may have information that is likely to assist in identifying risks of material misstatement, auditors of public sector entities may obtain information from additional sources such as from the auditors that are involved in performance or other audits related to the entity.

#### Inquiries of the Internal Audit Function

##### Why Inquiries are Made of the Internal Audit Function (if any)

A25. If an entity has an internal audit function, inquiries of the appropriate individuals within the function may assist the auditor in understanding the entity and its environment and the entity's system of internal control in the identification and assessment of risks.

A26. [Moved to **Appendix 4**]

A27. [Moved to **Appendix 4**]

A28. [Moved to **Appendix 4**]

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<sup>13</sup> ISA 260 (Revised), *Communication with Those Charged with Governance*, paragraph 4(b)

## Considerations specific to public sector entities

A29. Auditors of public sector entities often have additional responsibilities with regard to internal control and compliance with applicable laws and regulations. Inquiries of appropriate individuals in the internal audit function can assist the auditors in identifying the risk of material noncompliance with applicable laws and regulations and the risk of control deficiencies related to financial reporting.

### *Analytical Procedures* (Ref: Para. 18(b))

#### Why Analytical Procedures are Performed as a Risk Assessment Procedure

A30. Analytical procedures performed as risk assessment procedures may identify aspects of the entity of which the auditor was unaware and may assist in identifying and assessing the risks of material misstatement by identifying characteristics relevant to the auditor's consideration of the inherent risk factors, such as change.

A31. Analytical procedures may also help identify inconsistencies, unusual transactions or events, and amounts, ratios, and trends that might indicate matters that have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud.

#### Types of Analytical Procedures

A32. Analytical procedures performed as risk assessment procedures may:

- Include both financial and non-financial information, for example, the relationship between sales and square footage of selling space or volume of goods sold (non-financial).
- Use data aggregated at a high level. Accordingly, the results of those analytical procedures may provide a broad initial indication about the likelihood of a material misstatement.

#### Example:

In the audit of many entities, including those with less complex business models and processes, and less complex information systems, the auditor may perform a simple comparison of information, such as the change in interim or monthly account balances from balances in prior periods, to obtain an indication of potentially higher risk areas.

A33. [Moved]

A34. This ISA deals with the auditor's use of analytical procedures as risk assessment procedures. ISA 520 deals with the auditor's use of analytical procedures as substantive procedures ("substantive analytical procedures"). Accordingly, analytical procedures performed as risk assessment procedures are not required to be performed in accordance with the requirements of ISA 520. However, the requirements and application material in ISA 520 may provide useful guidance to the auditor when performing analytical procedures as part of the risk assessment procedures.

#### Automated Tools and Techniques

A34a. Analytical procedures can be performed using a number of tools or techniques, which may be automated. Applying automated analytical procedures to the data may be referred to as data analytics.

Example:

The auditor may use a spreadsheet to perform a comparison of actual recorded amounts to budgeted amounts, or may perform a more advanced procedure by extracting data from the entity's information system, and further analyzing this data using visualization techniques to identify more specific areas of possible misstatement.

*Observation and Inspection* (Ref: Para. 18(c))

Why Observation and Inspection are Performed as Risk Assessment Procedures

A35. Observation and inspection may support inquiries of management and others, and may also provide information about the entity and its environment.

Scalability

A35a. Where policies or procedures are not documented, or the entity has less formalized controls, the auditor may still be able to obtain some audit evidence to support the identification and assessment of the risks of material misstatement through observation or inspection of the performance of the control.

Examples:

- The auditor may obtain an understanding of controls over an inventory count, even if they have not been documented by the entity, through direct observation.
- The auditor may be able to observe segregation of duties.
- The auditor may be able to observe passwords being entered.

*Observation and Inspection as Risk Assessment Procedures*

A35b. Risk assessment procedures may include observation or inspection of the following:

- The entity's operations.
- Internal documents (such as business plans and strategies), records, and internal control manuals.
- Reports prepared by management (such as quarterly management reports and interim financial statements) and those charged with governance (such as minutes of board of directors' meetings).
- The entity's premises and plant facilities.
- Information obtained from external sources such as trade and economic journals; reports by analysts, banks, or rating agencies; or regulatory or financial publications; or other external documents about the entity's financial performance (such as those referred to in paragraph A74).
- The behaviors and actions of management or those charged with governance (such as the observation of an audit committee meeting).

### Automated Tools or Techniques

A35c. Automated tools or techniques may also be used to observe or inspect, in particular assets, for example through the use of remote observation tools (e.g., a drone).

### Considerations specific to public sector entities

A36. Risk assessment procedures performed by auditors of public sector entities may also include observation and inspection of documents prepared by management for the legislature, for example as documents related to mandatory performance reporting.

### *Other Relevant Sources of Audit Evidence* (Ref: Para. 19)

#### Why the Auditor Considers Other Relevant Sources of Audit Evidence

A37. [Sentence moved to para. A38] Information obtained from other relevant sources of audit evidence may be relevant to the identification and assessment of the risks of material misstatement by providing information and insights about.

- The nature of the entity and its business risks, and what may have changed from previous periods.
- The integrity and ethical values of management and those charged with governance, which may also be relevant to the auditor's understanding of the control environment.
- The applicable financial reporting framework and its application to the nature and circumstances of the entity.

### Information from Other Relevant Sources of Audit Evidence

A38. Other relevant sources of audit evidence come from:

- The auditor's acceptance or continuance of the client relationship or the audit engagement, in accordance with ISA 220, including from procedures regarding the acceptance and continuance of client relationships and audit engagements, and the conclusions reached.<sup>14</sup>
- Other engagements performed for the entity by the engagement partner. Such engagements may include agreed-upon procedures engagements or other audit or assurance engagements, including engagements to address incremental reporting requirements in the jurisdiction.

### *Information from the Auditor's Previous Experience with the Entity and Previous Audits* (Ref: Para. 21)

#### Why Information from Previous Audits is Important to the Current Audit

A39. The auditor's previous experience with the entity, and audit procedures performed in previous audits, may provide the auditor with information that is relevant to the auditor's determination of the nature and extent of risk assessment procedures, and the identification and assessment of risk. Such information may include:

- Past misstatements and whether they were corrected on a timely basis.

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<sup>14</sup> ISA 220, *Quality Control for an Audit of Financial Statements*, paragraph 12

- The nature of the entity and its environment, and the entity’s system of internal control (including control deficiencies).
- Significant changes that the entity or its operations may have undergone since the prior financial period.
- Those particular types of transactions and other events or account balances (and related disclosures) where the auditor experienced difficulty in performing the necessary audit procedures, for example, due to their complexity.

#### Evaluating Information from Prior Periods

A40. In evaluating whether information obtained in prior periods remains relevant and reliable for the current audit, the auditor may consider whether changes have occurred that may affect the relevance or reliability of such information.

**Example:**

To determine whether information from prior periods remains relevant, the auditor may make inquiries and perform other appropriate risk assessment procedures, such as walk-throughs of relevant systems.

#### *Engagement Team Discussion* (Ref: Para. 22–22A)

##### Why the Engagement Team is Required to Discuss the Susceptibility of the Entity’s Financial Statements to Material Misstatement

A40a. The discussion among the engagement team about the susceptibility of the entity’s financial statements to material misstatement:

- Provides an opportunity for more experienced engagement team members, including the engagement partner, to share their insights based on their knowledge of the entity. Sharing information contributes to an enhanced understanding by all engagement team members.
- Allows the engagement team members to exchange information about the business risks to which the entity is subject, how the inherent risk factors may affect the classes of transactions, account balances and disclosures, and about how and where the financial statements might be susceptible to material misstatement due to fraud or error.
- Assists the engagement team members to gain a better understanding of the potential for material misstatement of the financial statements in the specific areas assigned to them, and to understand how the results of the audit procedures that they perform may affect other aspects of the audit including the decisions about the nature, timing and extent of further audit procedures. In particular, the discussion assists engagement team members in further considering contradictory information based on each member’s own understanding of the nature and circumstances of the entity.
- Provides a basis upon which engagement team members communicate and share new information obtained throughout the audit that may affect the assessment of risks of material misstatement or the audit procedures performed to address these risks.

ISA 240 requires the engagement team discussion to place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud may occur.<sup>15</sup>

A40b. The engagement team may also have an opportunity to exercise professional skepticism while performing risk assessment procedures, such as through identifying and discussing contradictory information obtained in performing those procedures, as well as in considering whether there are indicators of possible management bias (both intentional and unintentional). Professional skepticism is necessary for the critical assessment of audit evidence, and a robust and open engagement team discussion, including for recurring audits, may lead to improved identification and assessment of the risks of material misstatement. Another outcome from the discussion may be that the auditor identifies specific areas of the audit for which exercising professional skepticism may be particularly important, and may lead to the involvement of more experienced members of the engagement team who are appropriately skilled to be involved in the performance of audit procedures related to those areas.

### Scalability

A41. When the engagement is carried out by a single individual (such as a sole practitioner) i.e., where an engagement team discussion would not be possible, consideration of the matters referred to in paragraphs A43 nonetheless may assist the auditor in identifying where there may be risks of material misstatement.

A41a. It is not always necessary or practical for the discussion to include all members in a single discussion (as, for example, in a multi-location audit), nor is it necessary for all the members of the engagement team to be informed of all the decisions reached in the discussion. The engagement partner may discuss matters with key members of the engagement team including, if considered appropriate, those with specific skills or knowledge, and those responsible for the audits of components, while delegating discussion with others, while taking into account of the extent of communication considered necessary throughout the engagement team. A communications plan, agreed by the engagement partner, may be useful.

A42. [*Moved*]

### Matters To Be Discussed

A43. As part of the discussion among the engagement team, consideration of the disclosure requirements of the applicable financial reporting framework assists in identifying early in the audit where there may be risks of material misstatement in relation to disclosures, even in circumstances where the applicable financial reporting framework only requires simplified disclosures. Matters the engagement team may discuss include:

- Changes in financial reporting requirements that may result in significant new or revised disclosures;
- Changes in the entity's environment, financial condition or activities that may result in significant new or revised disclosures, for example, a significant business combination in the period under audit;

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<sup>15</sup> ISA 240, paragraph 15

- Disclosures for which obtaining sufficient appropriate audit evidence may have been difficult in the past; and
- Disclosures about complex matters, including those involving significant management judgment as to what information to disclose.

A44. [Moved]

A45. [Moved]

#### Considerations Specific to Public Sector Entities

A46. As part of the discussion among the engagement team by auditors of public sector entities, consideration may also be given to any additional broader objectives, and related risks, arising from the audit mandate or obligations for public sector entities.

### **Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework and the Entity’s System of Internal Control (Ref: Para. 23)**

#### *Why an Understanding of Relevant Aspects of the Entity and Its Environment, the Applicable Financial Reporting Framework, and the Components of the Entity’s System of Internal Control is Required*

A47. The auditor’s understanding of the entity and its environment, and the applicable financial reporting framework, assists the auditor in understanding the events and conditions that are relevant to the entity, and in identifying relevant inherent risk factors. Such information establishes a frame of reference within which the auditor identifies and assesses risks of material misstatement. This frame of reference also assists the auditor in planning the audit and exercising professional judgment throughout the audit, for example, when:

- Identifying and assessing risks of material misstatement of the financial statements in accordance with ISA 315 (Revised) or other relevant standards (e.g., relating to risks of fraud in accordance with ISA 240 or when identifying or assessing risks related to accounting estimates in accordance with ISA 540 (Revised));
- Determining materiality or performance materiality in accordance with ISA 320;<sup>16</sup> or
- Considering the appropriateness of the selection and application of accounting policies, and the adequacy of financial statement disclosures.

This understanding assists the auditor in identifying areas in the financial statements where material misstatements may be more likely to arise and assists the auditor in exercising professional skepticism throughout the audit.

A47a. The auditor’s understanding of the entity and its environment, and the applicable financial reporting framework, may also inform how the auditor plans and performs further audit procedures, for example, when:

- Developing expectations for use when performing analytical procedures in accordance with ISA 520;<sup>17</sup>

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<sup>16</sup> ISA 320, *Materiality in Planning and Performing an Audit*, paragraphs 10–11

<sup>17</sup> ISA 520, *Analytical Procedures*, paragraph 5



- Designing and performing further audit procedures to obtain sufficient appropriate audit evidence in accordance with ISA 330;<sup>18</sup> and
- Evaluating the sufficiency and appropriateness of audit evidence obtained (e.g., relating to assumptions or management’s oral and written representations).

A47b. The auditor’s understanding of the entity and its environment and the applicable financial framework may also inform the auditor’s understanding of the entity’s system of internal control, including the information system. This understanding assists the auditor in developing initial expectations about the classes of transactions, account balances and disclosures. The auditor’s initial expectations formed about the classes of transactions, account balances and disclosures may assist the auditor in determining the significant classes of transactions, account balances and disclosures when obtaining an understanding of the information system.

Example:

The auditor may have an expectation that certain significant classes of transactions related to revenue exist, but in obtaining the understanding about the flows of information in the information system, the auditor may identify additional classes of transactions related to revenue that may be significant.

### Scalability

A47c. The nature and extent of the understanding needed is a matter of the auditor’s professional judgment and will vary from entity to entity based on the nature and circumstances of the entity, including:

- The size and complexity of the entity, including its IT environment;
- The auditor’s previous experience with the entity;
- The nature of the entity’s systems and processes, including whether they are formalized or not; and
- The nature and form of the entity’s documentation.

A47d. The entity’s use of IT and the nature and extent of changes in the IT environment may also affect the specialized skills that are needed to assist with obtaining the required understanding.

A47e. Accordingly, the auditor’s risk assessment procedures to obtain the overall understanding may be less extensive in audits of less complex entities and more extensive for entities that are more complex. The depth of the overall understanding that is required by the auditor is expected to be less than that possessed by management in managing the entity.

### Obtaining the Required Understanding

A47f. Obtaining an understanding of the entity and its environment, the applicable financial reporting framework and the entity’s system of internal control is a dynamic and iterative process of gathering, updating and analyzing information and continues throughout the audit. Therefore, the auditor’s expectations may change as new information is obtained.

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<sup>18</sup> ISA 330, *The Auditor’s Responses to Assessed Risks*

A47g. The auditor applies professional judgment in determining whether the understanding required by paragraph 23 is sufficient to provide an appropriate basis to achieve the objectives in paragraph 17(a) and (b).

A47h. The auditor is only required to obtain an understanding of the relevant aspects of the entity and its environment, the applicable financial reporting framework, and the components of the entity's system of internal control as set out in the relevant definitions for the purpose of paragraphs 17() and (b) (i.e., meeting the objectives of this standard.)

*The Entity and Its Environment* (Ref: Para. 23(a))

A48. In obtaining an understanding of the entity and its environment, the auditor may be able to enhance the understanding by using automated tools and techniques. For example, the auditor may use automated techniques to understand flows of transactions and processing as part of the auditor's procedures to understand the information system. An outcome of these procedures may be that the auditor obtains information about the entity's organizational structure or those with whom the entity conducts business (e.g., vendors, customers, related parties).

How Events or Conditions are Subject To, or Affected By, the Inherent Risk Factors

**Appendix 2** provides examples of events and conditions that may indicate susceptibility to risks of material misstatement, categorized by inherent risk factor.

Why the auditor considers the inherent risk factors when understanding the entity and its environment

A48a. When understanding the entity and its environment, the auditor considers how events or conditions related to the entity and its environment are subject to, or affected by, the inherent risk factors. These inherent risk factors help with the auditor's understanding of where risks of material misstatement may arise when the entity has applied the applicable financial reporting framework to these events or conditions by highlighting which classes of transactions, account balances and disclosures may be affected and therefore which may be significant classes of transactions, account balances and disclosures. Understanding whether, and the relative degree to which, the inherent risk factors affect the events and conditions may also assist the auditor in identifying and assessing the risks of material misstatement at the assertion level.

The Effect of the Inherent Risk Factors on a Class of Transactions, Account Balance or Disclosure

A48b. The extent to which a class of transactions, account balance or disclosure is subject to, or affected by, complexity or subjectivity, is often closely related to the extent to which it is subject to change or uncertainty.

Example:  
If the entity has an accounting estimate based on assumptions that are sensitive to changes, the greater the risk that there may be a material misstatement.

A48c. The greater the extent to which a class of transactions, account balance or disclosure is subject to, or affected by, complexity or subjectivity, the greater the need for the auditor to apply professional skepticism. Further, when a class of transactions, account balance or disclosure is subject to, or

affected by, complexity, subjectivity, change or uncertainty, these inherent risk factors may create opportunity for management bias, whether unintentional or intentional, and affect susceptibility to misstatement due to management bias or misappropriation of assets. The auditor's identification of risks of material misstatement, and assessment of inherent risk at the assertion level, are also affected by the interrelationships among the inherent risk factors.

A48d. Events or conditions that may be affected by, or subject to, the susceptibility of misstatement due to management bias or misappropriation of assets may be indicative of increased risks of material misstatement due to fraud. Accordingly, this may be relevant information for use in accordance with paragraph 24 of ISA 240, which requires the auditor to evaluate whether the information obtained from the other risk assessment procedures and related activities indicates that one or more fraud risk factors are present.

#### Obtaining an Understanding of Relevant Aspects of the Entity and Its Environment

A48e. The relevant aspects of the entity and its environment are defined in paragraph 16(gc).

#### The Entity's Organizational Structure, Ownership and Governance, and Business Model

The entity's organizational structure and ownership

A49. An understanding of the entity's organizational structure and ownership may enable the auditor to understand such matters as:

- The complexity of the entity's structure.

**Example:**

The entity may be a single entity or the entity's structure may include subsidiaries, divisions or other components in multiple locations. Further, the legal structure may be different from the operating structure. Complex structures often introduce factors that may give rise to increased susceptibility to risks of material misstatement. Such issues may include whether goodwill, joint ventures, investments, or special-purpose entities are accounted for appropriately and whether adequate disclosure of such issues in the financial statements have been made.

- The ownership, and relationships between owners and other people or entities, including related parties. This understanding may assist in determining whether related party transactions have been appropriately identified, accounted for, and adequately disclosed in the financial statements.<sup>19</sup>

<sup>19</sup> ISA 550 establishes requirements and provide guidance on the auditor's considerations relevant to related parties.

- The distinction between the owners, those charged with governance and management.

Example:

In less complex entities, owners of the entity may be involved in managing the entity, therefore there is little or no distinction. In contrast, such as in some listed entities, there may be a clear distinction between management, the owners of the entity, and those charged with governance. <sup>20</sup>

- The entity's IT environment.

Example:

An entity's IT environment may be relatively simple because it consists only of commercial software for which the entity does not have access to the underlying source code to which no changes have been made. Alternatively, an entity may have multiple legacy IT systems in diverse businesses that are not well integrated resulting in a complex IT environment. The entity may be using external or internal service providers for aspects of its IT environment (e.g., outsourcing the hosting of its IT environment to a third party or using a shared service center for central management of IT processes in a group).

### Automated Tools and Techniques

A49a. In obtaining an understanding of the entity and its environment, the auditor may be able to enhance the understanding by using automated tools and techniques. For example, the auditor may use automated techniques to understand flows of transactions and processing as part of the auditor's procedures to understand the information system. An outcome of these procedures may be that the auditor obtains information about the entity's organizational structure or those with whom the entity conducts business (e.g., vendors, customers, related parties).

### Considerations specific to public sector entities

A50. Ownership of a public sector entity may not have the same relevance as in the private sector because decisions related to the entity may be initiated outside of the entity as a result of political processes. Therefore, management may not have control over decisions that are made. Matters that may be relevant include understanding the ability of the entity to make unilateral decisions, and the ability of other public sector entities to control or influence the entity's mandate and strategic direction.

Example:

A public sector entity may be subject to laws or other directives from authorities that require it to obtain approval from parties external to the entity of its strategy and objectives prior to it implementing them. Therefore, matters related to understanding the legal structure of the entity may include applicable laws and regulations, and the classification of the entity (i.e. whether the entity is a ministry, department, agency or other type of entity).

<sup>20</sup> ISA 260 (Revised), paragraphs A1 and A2, provides guidance on the identification of those charged with governance and explains that in some cases, some or all of those charged with governance may be involved in managing the entity.

## Governance

### Why the auditor obtains an understanding of governance

A51. Understanding the entity's governance assists the auditor with understanding of the entity's ability to provide appropriate oversight of its system of internal control. However, this understanding may also provide evidence of deficiencies, which may indicate an increase the susceptibility of the entity's financial statements to risks of material misstatement.

### Understanding the Entity's Governance

A51a. Matters that may be relevant for the auditor to consider in obtaining an understanding of the governance of the entity include:

- Whether any or all of those charged with governance are involved in managing the entity.
- The existence (and separation) of a non-executive Board, if any, from executive management.
- Whether those charged with governance hold positions that are an integral part of the entity's legal structure, for example as directors.
- The existence of sub-groups of those charged with governance such as an audit committee, and the responsibilities of such a group.
- The responsibilities of those charged with governance for oversight of financial reporting, including approval of the financial statements.

### The Entity's Business Model

### Why the auditor obtains an understanding of the entity's business model and its related risks

A52. Understanding the entity's objectives, strategy and business model helps the auditor to understand the entity at a strategic level and to understand the business risks the entity takes and faces. An understanding of the business risks that have an effect on the financial statements assists the auditor in identifying risks of material misstatement, since most business risks will eventually have financial consequences and, therefore, an effect on the financial statements.

#### Example:

An entity's business model may rely on the use of IT in different ways:

- The entity sells widgets from a physical store, and uses an advanced stock and point of sale system to record the selling of widgets; or
- The entity sells widgets online so that all sales transactions are processed in an IT environment, including initiation of the transactions through a website.

For both of these entities the business risks arising from a significantly different business model would be substantially different, notwithstanding both entities sell widgets.

A53 – A55: [*Moved to **Appendix 1***]

## Relevant Aspects of the Business Model Required to be Understood

**Appendix 1** explains the objectives and scope of the entity's business model and provides examples of matters that the auditor may consider in understanding the activities of the entity that may be included in the business model. In addition, the appendix explains other matters that may be considered when auditing financial statements of special purpose entities.

**Appendix 2** provides explanations about the inherent risk factors as well as providing examples of events and conditions that may indicate risks of material misstatement. The events and conditions have been categorized by the inherent risk factor that may have the greatest effect in the circumstances.

A56. [Moved]

A57. [Moved]

A58. [Moved]

A59. Not all aspects of the business model are relevant aspects for the auditor's understanding. Business risks are broader than the risks of material misstatement of the financial statements, although business risks include the latter. The auditor does not have a responsibility to identify or assess all business risks because not all business risks give rise to risks of material misstatement.

A59a. Business risks increasing the susceptibility to risks of material misstatement may arise from:

- Inappropriate objectives or strategies, ineffective execution of strategies, or change or complexity.
- A failure to recognize the need for change may also give rise to business risk, for example, from:
  - The development of new products or services that may fail;
  - A market which, even if successfully developed, is inadequate to support a product or service; or
  - Flaws in a product or service that may result in legal liability and reputational risk.
- Incentives and pressures on management, which may result in intentional or unintentional management bias, and therefore affect the reasonableness of significant assumptions and the expectations of management or those charged with governance.

A60. [Moved to **Appendix 1**]

A61. Examples of matters that the auditor may consider when obtaining an understanding of the entity's business model, objectives, strategies and related business risks that may result in a risk of material misstatement of the financial statements include possible risks arising from:

- Industry developments, such as the lack of personnel or expertise to deal with the changes in the industry;
- New products and services that may lead to increased product liability;
- Expansion of the entity's business, and demand has not been accurately estimated;

- New accounting requirements where there has been incomplete or improper implementation;
- Regulatory requirements resulting in increased legal exposure;
- Current and prospective financing requirements, such as loss of financing due to the entity's inability to meet requirements;
- Use of IT, such as the implementation of a new IT system that will affect both operations and financial reporting; or
- The effects of implementing a strategy, particularly any effects that will lead to new accounting requirements.

A62. Ordinarily, management identifies business risks and develops approaches to address them. Such a risk assessment process is part of the entity's system of internal control and is discussed in paragraph 29–31 and paragraphs A115–A121.

#### Considerations specific to public sector entities

A62a Entities operating in the public sector may create and deliver value in different ways to those creating wealth for owners but will still have a 'business model' to promote value in the public interest. Matters public sector auditors may obtain an understanding of that are relevant to the business model of the entity, include:

- Knowledge of relevant government activities, including related programs.
- Program objectives and strategies, including public policy elements.

A63. For the audits of public sector entities, "management objectives" may be influenced by requirements to demonstrate public accountability and may include objectives which have their source in law, regulation or other authority.

#### Relevant Industry, Regulatory and Other External Factors

##### Industry factors

A64. Relevant industry factors include industry conditions such as the competitive environment, supplier and customer relationships, and technological developments. Matters the auditor may consider include:

- The market and competition, including demand, capacity, and price competition.
- Cyclical or seasonal activity.
- Product technology relating to the entity's products.
- Energy supply and cost.

A65. The industry in which the entity operates may give rise to specific risks of material misstatement arising from the nature of the business or the degree of regulation.

Example:

In the construction industry, long-term contracts may involve significant estimates of revenues and expenses that give rise to risks of material misstatement. In such cases, it is important that the engagement team include members with sufficient relevant knowledge and experience.<sup>21</sup>

### Regulatory Factors

A66. Relevant regulatory factors include the regulatory environment. The regulatory environment encompasses, among other matters, the applicable financial reporting framework and the legal and political environment and any changes thereto. Matters the auditor may consider include:

- Regulatory framework for a regulated industry, for example, prudential requirements, including related disclosures.
- Legislation and regulation that significantly affect the entity's operations, for example, labor laws and regulations.
- Taxation legislation and regulations.
- Government policies currently affecting the conduct of the entity's business, such as monetary, including foreign exchange controls, fiscal, financial incentives (for example, government aid programs), and tariffs or trade restriction policies.
- Environmental requirements affecting the industry and the entity's business.

A67. ISA 250 (Revised) includes some specific requirements related to the legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates.<sup>22</sup>

### Considerations specific to public sector entities

A68. For the audits of public sector entities, there may be particular laws or regulations that affect the entity's operations. Such elements may be an essential consideration when obtaining an understanding of the entity and its environment.

### Other External Factors

A69. Other external factors affecting the entity that the auditor may consider include the general economic conditions, interest rates and availability of financing, and inflation or currency revaluation.

### Relevant Measures Used to Assess the Entity's Financial Performance (Ref: Para. 23(a)(iii))

A70. [Moved]

### Why the auditor understands relevant measures used by management

A70a. An understanding of the entity's relevant measures assists the auditor in considering whether such measures, whether used externally or internally, create pressures on the entity to achieve performance targets. These pressures may motivate management to take actions that increase the susceptibility to misstatement due to management bias or misappropriation of assets (e.g. to improve

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<sup>21</sup> ISA 220, paragraph 14

<sup>22</sup> ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*, paragraph 13



the business performance or to intentionally misstate the financial statements) (see ISA 240 for requirements and guidance in relation to the risks of fraud).

A70b Relevant measures may also indicate to the auditor the likelihood with which risks of misstatement of related financial statement information exist. For example, performance measures may indicate that the entity has unusually rapid growth or profitability when compared to that of other entities in the same industry.

A70c. Management and others ordinarily measure and review those matters they regard as important. [Previously para. A77] Inquiry of management may reveal that it relies on certain key indicators, whether publicly available or not, for evaluating financial performance and taking action. In such cases, the auditor may identify relevant performance measures, whether internal or external, by considering the information that the entity uses to manage its business. If such inquiry indicates an absence of performance measurement or review, there may be an increased risk of misstatements not being detected and corrected.

A70d. Key indicators used for evaluating financial performance may include:

- Key performance indicators (financial and non-financial) and key ratios, trends and operating statistics.
- Period-on-period financial performance analyses.
- Budgets, forecasts, variance analyses, segment information and divisional, departmental or other level performance reports.
- Employee performance measures and incentive compensation policies.
- Comparisons of an entity's performance with that of competitors.

A71. [Moved]

A72. [Moved]

A73. [Moved]

#### Scalability

A73a. The procedures undertaken to understand the entity's relevant performance measures may vary depending on the size or complexity of the entity, as well as the involvement of owners or those charged with governance in the management of the entity.

#### Examples:

- For some less complex entities, the terms of the entity's bank borrowings (i.e., bank covenants) may be linked to specific performance measures related to the entity's performance or financial position (e.g., a maximum working capital amount). The auditor's understanding of the relevant performance measures used by the bank may help identify areas where there is increased susceptibility to the risk of material misstatement.
- For some entities whose nature and circumstances are more complex, such as those operating in the insurance or banking industries, performance or financial position may be measured against regulatory requirements (e.g., regulatory ratio requirements, such as capital adequacy and liquidity ratios performance hurdles). The auditor's understanding of

these performance measures may help identify areas where there is increased susceptibility to the risk of material misstatement.

#### Other auditor considerations

A74. External parties may also review and analyze the entity's financial performance, in particular for entities where financial information is publicly available. The auditor may also consider publicly available information to help the auditor further understand the business or identify contradictory information such as information from:

- Analysts or credit agencies.
- Taxation authorities.
- Regulators.
- Trade unions.
- Providers of finance.

Such financial information can often be obtained from the entity being audited.

A75. [Moved]

A76. [Deleted]

A77. [Moved]

A77a. The measurement and review of financial performance is not the same as the monitoring of the system of internal control (discussed as a component of the system of internal control in paragraphs A122–A135), though their purposes may overlap:

- The measurement and review of performance is directed at whether business performance is meeting the objectives set by management (or third parties).
- In contrast, monitoring of the system of internal control is concerned with monitoring the effectiveness of controls including those related to management's measurement and review of financial performance.

In some cases, however, performance indicators also provide information that enables management to identify control deficiencies. Considerations specific to public sector entities

#### Considerations specific to public sector entities

A78. In addition to considering relevant measures used by a public sector entity to assess the entity's financial performance, auditors of public sector entities may also consider non-financial information such as achievement of public benefit outcomes (for example, the number of people assisted by a specific program).

*The Applicable Financial Reporting Framework* (Ref: Para. 23(b))

#### Scalability

A78a. Some financial reporting frameworks allow smaller entities to provide simpler and less detailed disclosures in the financial statements. However, this does not relieve the auditor of the responsibility

to obtain an understanding of the entity and its environment, the applicable financial reporting framework as it applies to the entity, and its related system of internal control.

#### Other auditor considerations

A79. Matters that the auditor may consider when obtaining an understanding of the entity's applicable financial reporting framework, and how it applies in the context of the nature and circumstances of the entity and its environment include:

- The entity's financial reporting practices in terms of the applicable financial reporting framework, such as:
  - Accounting principles and industry-specific practices, including for industry-specific significant classes of transactions, account balances and related disclosures in the financial statements (for example, loans and investments for banks, or research and development for pharmaceuticals).
  - Revenue recognition.
  - Accounting for financial instruments, including related credit losses.
  - Foreign currency assets, liabilities and transactions.
  - Accounting for unusual or complex transactions including those in controversial or emerging areas (for example, accounting for cryptocurrency).
- An understanding of the entity's selection and application of accounting policies, including any changes thereto as well as the reasons therefore, may encompass such matters as:
  - The methods the entity uses to recognize, measure, present and disclose significant and unusual transactions.
  - The effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.
  - Changes in the environment, such as changes in the applicable financial reporting framework or tax reforms that may necessitate a change in the entity's accounting policies.
  - Financial reporting standards and laws and regulations that are new to the entity and when and how the entity will adopt, or comply with, such requirements.

A80. Obtaining an understanding of the entity and its environment assists the auditor in considering where changes in the entity's financial reporting (e.g., from prior periods) may be expected.

**Example:**

If the entity has had a significant business combination during the period, the auditor would likely expect changes in classes of transactions, account balances and disclosures associated with that business combination. Alternatively, if there were no significant changes in the financial reporting framework during the period the auditor's understanding may help confirm that the understanding obtained in the prior period remains applicable.

A81. [Moved]

Considerations specific to public sector entities

A82. The applicable financial reporting framework in a public sector entity is determined by the legislative and regulatory frameworks relevant to each jurisdiction or within each geographical area. Matters that may be considered in the entity's application of the applicable financial reporting requirements, and how it applies in the context of the nature and circumstances of the entity and its environment, include whether the entity applies a full accrual-basis of accounting (such as the International Public Sector Accounting Standards), a cash-basis of accounting, or a hybrid.

A83. [Moved]

A84. [Moved]

A85. [Moved]

A86. [Moved]

A87. [Moved]

A88. [Deleted]

**Obtaining an Understanding of the Entity's System of Internal Control** (Ref: Para. 23(c))

**Appendix 3** further describes the nature of the entity's system of internal control and inherent limitations of internal control, respectively. Appendix 3 also provides further explanation of the components of a system of internal control for the purposes of the ISAs.

A89. [Deleted]

A90. [Moved]

A91. [Moved]

A92. [Moved]

*Relevant Aspects of the Entity's System of Internal Control*

Relevant Aspects of the Entity's System of Internal Control Required to be Understood

A93. [Deleted and part moved]

A93a. For the purposes of this ISA, understanding the relevant aspects of the entity's system of internal control comprises:

- (a) Obtaining an understanding of the relevant aspects of each of the components of the entity's system of internal control, as defined, that are relevant to the preparation of the financial statements in accordance with the requirements of the applicable financial reporting framework; and
- (b) Evaluating those aspects, for which the understanding has been obtained, for each of the components of the entity's system of internal control as required by paragraphs 28–36 and paragraph 42

- A94. Included within the entity's system of internal control are aspects that relate to the entity's reporting objectives, including its financial reporting objectives, but may also include aspects that relate to its operations or compliance objectives, when such aspects are relevant to financial reporting.

Example:

Controls over compliance with laws and regulations may be relevant to financial reporting when such controls are relevant to the entity's preparation of contingency disclosures in the financial statements.

- A94a. Understanding how the entity initiates transactions and captures information relevant to financial reporting as part of the auditor's understanding of the information system may include information from the entity's systems and controls designed to address compliance and operations objectives. Further, some entities may have information systems that are highly integrated such that controls may be designed in a manner to simultaneously achieve financial reporting, compliance and operational objectives, and combinations thereof.
- A95. For the purposes of this ISA, the system of internal control relevant to financial reporting means the system of internal control relevant to the preparation of the financial statements in accordance with the requirements of the applicable financial reporting framework.

#### Scalability

- A95a. The way in which the system of internal control is designed, implemented and maintained varies with an entity's size and complexity. For example, smaller and less complex entities may use less structured and simpler controls (i.e., policies and procedures) to achieve their objectives.

#### Considerations Specific to Public Sector Entities

- A96. Auditors of public sector entities often have additional responsibilities with respect to internal control, for example, to report on compliance with an established code of practice or reporting on spending against budget. Auditors of public sector entities may also have responsibilities to report on compliance with law, regulation or other authority. As a result, their considerations about the system of internal control may be broader and more detailed.

#### Information Technology in the Components of the System of Internal Control

**Appendix 5** provides further guidance on understanding the entity's use of IT in the components of the system of internal control.

- A97. [Parts moved to **Appendix 5**] The overall objective and scope of an audit does not differ whether an entity operates in a mainly manual environment, a completely automated environment, or an environment involving some combination of manual and automated elements (i.e., manual and automated controls and other resources used in the entity's system of internal control).
- A98. [Moved to **Appendix 5**]

#### *Understanding the Nature of the Components of the Entity's System of Internal Control*

- A99. The components of the entity's system of internal control for the purpose of this ISA may not necessarily reflect how an entity designs, implements and maintains its system of internal control, or

how it may classify any particular component. Entities may use different terminology or frameworks to describe the various aspects of the system of internal control. For the purpose of an audit, auditors may also use different terminology or frameworks provided all the components described in this ISA are addressed.

A100. [Moved]

A101. [Moved]

A102. The nature of each of the components of the entity's system of internal control may also affect the auditor's identification and assessment of the risks of material misstatement:

- The auditor's understanding of the entity's control environment, entity's risk assessment process, and the entity's process to monitor controls components are more likely to affect the identification and assessment of risks of material misstatement at the financial statement level.
- The auditor's understanding of the information system and communication component, and the control activities component, are more likely to affect the identification and assessment of risks of material misstatement at the assertion level.

A103. [Deleted]

A104. [Deleted]

#### **Understanding the Components of the Entity's System of Internal Control** (Ref: Para. 27–39)

*Control Environment, The Entity's Risk Assessment Process and the Entity's Process to Monitor the System of Internal Control* (Ref: Para. 28–33)

Why the Auditor is Required to Evaluate the Relevant Aspects of the Control Environment, The Entity's Risk Assessment Process and the Entity's Process to Monitor the System of Internal Control

A104a. The control environment provides the overall foundation for the operation of the other components of the system of internal control. The control environment does not directly prevent, or detect and correct, misstatements. It may, however, influence the effectiveness of controls in the other components of internal control. Similarly, the entity's risk assessment process and its process for monitoring the system of internal control are designed to operate in a manner that also supports the entire system of internal control.

A104b. Because these components are foundational to the entity's system of internal control, any weaknesses in their operation could have pervasive effects to the preparation of the financial statements. Therefore, the auditor's understanding and evaluations of these components affect the auditor's identification and assessment of risks of material misstatement at the financial statement level, and may also affect the identification and assessment of risks of material misstatement at the assertion level. Identified risks of material misstatement at the financial statement level affects the auditor's design of overall responses, which have implications for the audit, including, as explained in ISA 330, an influence on the nature, timing and extent of the auditor's further procedures.<sup>23</sup>

A104c. The auditor's intentions to test the operating effectiveness of controls may also be influenced by the identified risks of material misstatement at the financial statement level.

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<sup>23</sup> ISA 330, paragraphs A2–A3

Example:

Controls over compliance with laws and regulations may be relevant to financial reporting when such controls are relevant to the entity's preparation of contingency disclosures in the financial statements.

A104d. The controls in these components are primarily indirect controls (i.e., controls that are not sufficiently precise to prevent, detect or correct misstatements at the assertion level but which may have an indirect effect on the likelihood that a misstatement will be detected or prevented on a timely basis). However, some controls within these components may also be direct controls.

Example:

*[Previously included in para. A125]*

Some monitoring activities, such as management or supervisory reviews, may be precise enough to address risks of material misstatement at the assertion level (i.e., direct controls).

Monitoring controls may also include certain activities performed by the internal audit function, some of which may be direct controls.

Control Environment (Ref: Para. 28)

A105. *[Moved to **Appendix 3**]*

A105a. The relevant aspects of the control environment are defined in paragraph 16(gb).

### Scalability

A106. The control environment relating to less complex entities is likely to vary from larger or more complex entities.

A106a. Those charged with governance in less complex entities may not include an independent or outside member, and the role of governance may be undertaken directly by the owner-manager where there are no other owners. Accordingly, some considerations about the entity's control environment may be inapplicable or less relevant.

A107. In addition, audit evidence for elements of the control environment in less complex entities may not be available in documentary form, in particular where communication between management and other personnel may be informal, but is still effective.

Examples:

- The organizational structure in a less complex entity will likely be simpler and may include a small number of employees involved in roles related to financial reporting.
- If the role of governance is undertaken directly by the owner-manager, the auditor may determine that the independence of those charged with governance is not relevant.
- Less complex entities may not have a written code of conduct but, instead, develop a culture that emphasizes the importance of integrity and ethical behavior through oral communication and by management example. Consequently, the attitudes, awareness and actions of management or the owner-manager are of particular importance to the auditor's understanding of a less complex entity's control environment.

Understanding the Relevant Aspects of the Control Environment (Ref: Para. 23(c))

A108. Audit evidence for the auditor's understanding of the control environment may be obtained through a combination of inquiries and other risk assessment procedures (i.e., corroborating inquiries through observation or inspection of documents).

A108a. In considering the extent to which management demonstrates a commitment to integrity and ethical values, the auditor may obtain an understanding through inquiries of management and employees about

- How management communicates to employees its views on business practices and ethical behavior; and
- Inspecting management's written code of conduct and observing whether management acts in a manner that supports that code.

Scalability

A108b. The risk assessment procedures performed to obtain the understanding of the control environment and therefore vary to the extent necessary, to provide an appropriate basis for the required evaluation in paragraph 30.

A109. [Moved to **Appendix 4**]

A110. [Moved]

Evaluating the Relevant Aspects of the Control Environment (Ref: Para. 28)

A110a. The auditor's evaluation of the relevant aspects of the entity's control environment is undertaken using the information from the understanding of the entity's control environment obtained.

Why the Auditor Evaluates the Relevant Aspects of the Control Environment

A111. [Moved]

A112. Some elements of an entity's control environment have a pervasive effect on assessing the risks of material misstatement. [Rest moved to **Appendix 3** and covered in para's A104 and b]



## Scalability

A113. Some entities may be dominated by a single individual who may exercise a great deal of discretion. The actions and attitudes of that individual may have a pervasive effect on the culture of the entity, which in turn may have a pervasive effect on the control environment. Such an effect may be positive or negative.

Example:

Direct involvement by a single individual may be key to enabling the entity to meet its growth and other objectives, and can also contribute significantly to an effective system of internal control. On the other hand, such concentration of knowledge and authority can also lead to an increased susceptibility to misstatement through management override of controls.

A114. In considering the involvement of those charged with governance, who are also independent, the auditor considers how the different elements of the control environment may be influenced by the philosophy and operating style of senior management. However, other elements may be more limited in their effect.

Example:

Human resource policies and procedure directed toward hiring competent financial, accounting, and IT personnel may reduce the risk of errors in processing and recording financial information. However, such policies and procedures may not mitigate a strong bias by top management to override controls (e.g. overstate earnings). Overall, although a control environment that provides an appropriate foundation for the system of internal control may help reduce the risk of fraud, an appropriate control environment is not necessarily an effective deterrent to fraud.

A114a. [Moved] The auditor's evaluation of the control environment as it relates to the entity's use of IT may include such matters as:

- Whether governance over IT is commensurate with the nature and size of the entity and its business operations enabled by IT, including the complexity or maturity of the entity's technology platform or architecture and the extent to which the entity relies on IT applications to support its financial reporting.
- The management organizational structure regarding IT and the resources allocated (for example, whether the entity has invested in an appropriate IT environment and necessary enhancements, or whether a sufficient number of appropriately skilled individuals have been employed including when the entity uses commercial software (with no or limited modifications)).

The Entity's Risk Assessment Process (Ref: Para. 30–31)

A115. [Moved to **Appendix 3**].

A116. [Deleted]

Understanding the Relevant Aspects of the Entity's Risk Assessment Process (Ref: Para. 30)

A117. The relevant aspects of the entity's risk assessment process are defined in paragraph 16(ge).

A117a. In order to understand how management and those charged with governance have identified business risks relevant to financial reporting objectives, and have decided about actions to address those risks, matters the auditor may consider include how management or, as appropriate, those charged with governance, have:

- Specified objectives with sufficient clarity to enable the identification and assessment of the risks relating to the objectives;
- Identified the risks to achieving the entity's objectives and analyzed the risks as a basis for determining how the risks should be managed;
- Considered the potential for fraud when considering the risks to achieving the entity's objectives;<sup>24</sup> and
- Identified and evaluated changes that could significantly affect the entity's system of internal control.

As explained in paragraph A59, not all business risks give rise to risks of material misstatement.

A118. [Deleted]

A119. [Deleted]

Evaluating Whether the Relevant Aspects of the Entity's Risk Assessment Process are Appropriate (Ref: Para. 30)

A119a. The auditor's evaluation of the relevant aspects of the entity's risk assessment process is undertaken using the information from the understanding of the entity's risk assessment process obtained.

#### Scalability

A120. Whether the relevant aspects of entity's risk assessment process is appropriate to the circumstances of the entity, including its nature, size, and complexity, is a matter of the auditor's professional judgment.

#### Example:

In some less complex entities, and particularly owner-managed entities, an appropriate risk assessment may be performed through the direct involvement of management or the owner-manager (e.g., the manager or owner-manager may routinely devote time to monitoring the activities of competitors and other developments in the market place to identify emerging business risks). The evidence of this risk assessment occurring in these types of entities is often not formally documented, but it may be evident from the discussions the auditor has with management that management are in fact performing risk assessment procedures.

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<sup>24</sup> See paragraph 17(a) of ISA 240

A121. [Moved]

The Entity's Process to Monitor the Entity's System of Internal Control (Ref: Para. 30)

A122. [Moved to **Appendix 3**]

#### Scalability

A123. In less complex entities, and in particular owner-manager entities, the auditor's understanding about the entity's process to monitor the system of internal control is often about how management or the owner-manager's is directly involved in operations, as there may not be any other monitoring activities.

Example:

Management may receive complaints from customers about inaccuracies in their monthly statement that alerts the owner-manager to issues with the timing of when customer payments are being recognized in the accounting records.

#### Distinguishing Monitoring Activities

A124. [Moved]

A125. [Moved]

Understanding the Relevant Aspects of the Entity's Process to Monitor the System of Internal Control (Ref: Para. 32)

A126. The relevant aspects of the entity's process to monitor the system of control are defined in paragraph 16(gd).

A126a. Matters that may be relevant for the auditor to consider when understanding how the entity monitors its system of internal control include:

- The design of the monitoring activities, for example whether it is periodic or ongoing monitoring;
- The performance and frequency of the monitoring activities;
- The evaluation of the results of the monitoring activities, on a timely basis, to determine whether the controls have been effective; and
- How identified deficiencies have been addressed through appropriate remedial actions, including timely communication of such deficiencies to those responsible for taking remedial action.

A127. The auditor may also consider how the entity's process to monitor the system of internal control addresses monitoring information processing controls that involve the use of IT. This may include, for example:

- Controls to monitor complex IT environments that:
  - Evaluate the continuing design effectiveness of information processing controls and modify them, as appropriate, for changes in conditions; or
  - Evaluate the operating effectiveness of information processing controls.

- Controls that monitor the permissions applied in automated information processing controls that enforce the segregation of duties.
- Controls that monitor how errors or control deficiencies related to the automation of financial reporting are identified and addressed.

A128. [Moved to **Appendix 3**]

A128a [Previously para. A124] For entities where there is no distinct process for monitoring the system of internal control, it may be difficult to distinguish between control activities related to the information system and activities related to monitoring. For such entities, understanding the process to monitor the system of internal control may include understanding periodic reviews of management accounting information that are designed to contribute to how the entity prevents or detects misstatements.

Sources of Information (Ref: Para. 33)

Why the Auditor Is Required to Understand the Sources of Information used for the Entity's Monitoring of the System of internal Control

A129. The auditor's understanding of the sources of information used by the entity in monitoring the entity's system of internal controls, including whether the information used is relevant and reliable, assist the auditor in evaluating whether the entity's process to monitor the entity's system of internal control is appropriate. If management assumes that information used for monitoring is accurate without having a basis for that assumption, errors that may exist in the information could potentially lead management to incorrect conclusions from its monitoring activities.

Other Sources of Information Used in the Entity's Process to Monitor the System of Internal Control

A130. Management's monitoring activities may use information in communications from external parties such as customer complaints or regulator comments that may indicate problems or highlight areas in need of improvement.

The Entity's Internal Audit Function

**Appendix 4** sets out further matters for consideration relating to the entity's internal audit function.

Why the Auditor is Required to Obtain an Understanding of the Role of Internal Audit in the Entity's Process to Monitor the System of Internal Control

A131. The auditor's inquiries of appropriate individuals within the internal audit function help the auditor obtain an understanding of the nature of the internal audit function's responsibilities. If the auditor determines that the function's responsibilities are related to the entity's financial reporting, the auditor may obtain further understanding of the activities performed, or to be performed, by the internal audit function by reviewing the internal audit function's audit plan for the period, if any, and discussing that plan with the appropriate individuals within the function. This understanding, together with the information obtained from the auditor's inquiries, may also provide information that is directly relevant to the auditor's identification and assessment of the risks of material misstatement.

A132. [Moved to **Appendix 4**]

A133. [Moved to **Appendix 4**]

A134. [Moved to **Appendix 4**]

A135. [Moved to **Appendix 4**]

Evaluating Whether the Relevant Aspects of the Entity's Process to Monitor the System of Internal Control are Appropriate (Ref: Para. 30)

A135a. The auditor's evaluation of the relevant aspects of the entity's process to monitor the system of internal control is undertaken using the information from the understanding of the entity's process to monitor the system of internal control obtained.

*The Information System and Communication, and Control Activities*

Why the Auditor is Required to Evaluate the Relevant Aspects of the Information System and Communication and Controls in the Control Activities Component (Ref: Para. 36)

A135b. The auditor understands and evaluates the relevant aspects of the entity's information system and communication because the entity's policies that define the flows of transactions and processing of information that support the preparation of the financial statements affect the auditor's identification and assessment of risks of material misstatement at the assertion level. This understanding and evaluation may also result in the identification of risks of material misstatement at the financial statement level when the results of the auditor's procedures are inconsistent with expectations about the entity's system of internal control that may have been set based on information obtained during the engagement acceptance or continuance process.

A135c. The control activities component includes controls related to all the components of the entity's system of internal controls and includes both direct and indirect controls. The auditor's identification and evaluation of controls in the control activities component is focused on information processing controls, which are control activities related to the entity's information system. However, there may be control activities that are direct controls that exist in the control environment, the entity's risk assessment process or the entity's process to monitor the system of internal control that may be identified. The auditor also identifies and evaluates general IT controls for IT applications and other aspects of the IT environment that the auditor has determined to be subject to risks arising from the use of IT because general IT controls support the continued effective functioning of information processing controls.

A135d. The auditor is not required to identify and evaluate all information processing controls related to the flows of transactions and information processing activities for the significant classes of transactions, account balances and disclosures.

A135e. The controls that the auditor is required to identify in accordance with paragraph 39 and evaluate the design and determine the implementation of in accordance with paragraph 42 are those:

- On which the auditor intends to rely on the operating effectiveness of in determining the nature, timing and extent of substantive procedures because the evaluation of such controls provides the basis for the auditor's design of test of control procedures in accordance with ISA 330. Further, when a control is not designed or implemented effectively, there is no benefit in testing it. Such controls include controls that address risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence.

- That address risks of material misstatement at the assertion level that have been assessed as higher on the spectrum of inherent risk because ISA 330 requires more persuasive audit evidence the higher the auditor's assessment of risk<sup>25</sup>. Such controls include controls that address significant risks and controls over journal entries. The auditor's identification and evaluation of such controls may provide the auditor with a greater understanding of the risks of material misstatement, including the identification of additional risks of material misstatement. This understanding also provides the basis for the auditor's design of the nature, timing and extent of substantive audit procedures that are responsive to the related assessed risks of material misstatement.

#### The Iterative Nature of the Auditor's Understanding and Evaluation of the Information System and Communication, and Control Activities

A135f. The auditor's understanding of the information system and the identification and evaluation of controls in the control activities component are risk assessment procedures that are interdependent with the auditor's identification and assessment of risks of material misstatement at the assertion level.

A135g. The auditor's understanding of the relevant aspects of the information system includes understanding the policies that define flows of information relating to the entity's significant classes of transactions, account balances, and disclosures in the financial statements. The auditor's understanding of the information system may be based on those classes of transactions, account balances and disclosures that the auditor expects to be significant classes of transactions, account balances and disclosures. The information obtained while gaining the understanding and performing the evaluation of the information system assists the auditor in determining which classes of transactions, account balances and disclosures are susceptible to material misstatement therefore are significant classes of transactions, account balances and disclosures.

A135h. The auditor's identification and evaluation of controls may first focus on controls over journal entries and controls on which the auditor plans to rely in designing the nature, timing and extent of substantive procedures because such controls are identified independent of the auditor's risk assessments. Based on the procedures performed to assess inherent risk for risks of material misstatement at the assertion level in accordance with paragraphs 48 through 50, the auditor may subsequently identify and evaluate controls over significant risks, controls that address risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence, and controls that address over risks that have been assessed as higher on the spectrum of inherent risk.

#### *The Information System and Communication (Ref: Para. 36)*

**Appendix 3**, Paragraphs 14–18, sets out further matters for consideration relating to the information system and communication.

#### Scalability

A135i. The information system, and related business processes in less complex entities is likely to be less sophisticated than in larger entities and involve a less complex IT environment, but the role of the

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<sup>25</sup> ISA 330, paragraph 7(b)

information system is just as important. Less complex entities with direct management involvement may not need extensive descriptions of accounting procedures, sophisticated accounting records, or written policies. Understanding the relevant aspects of the entity's information system may therefore require less effort in an audit of a less complex entity, and may be more dependent on inquiry than on review of documentation. The need to obtain an understanding, however, remains important to identifying risks of material misstatement.

#### Relevant Aspects of the Information System and Communication

A136. [Moved to **Appendix 3**]

A136a. The relevant aspects of the information system and communication component are defined in paragraph 16(gf).

A137. [Moved]

A137a. Matters the auditor may consider when understanding the controls in the information system and communication component include the nature of:

- (a) The data or information relating to transactions, other events and conditions to be processed;
- (b) The information processing to maintain the integrity of that data or information; and
- (c) The information processes, personnel and other resources used in the information processing process.

A137b. Obtaining an understanding of the entity's business processes, which include how transactions are originated, assists the auditor in obtaining an understanding of the entity's information system in a manner that is appropriate to the entity's circumstances.

A138. [Moved to **Appendix 5**]

A139. [Moved]

A140. [Moved]

A141. [Moved]

A141a. The objective of information processing is to capture, store and process data from internal and external sources, and to produce the entity's accounting records and the information that the entity needs to include in its financial statements. The objective of those processes is also to comply with the requirements and principles in the applicable financial reporting framework, and in other applicable laws or regulations.

A141b. [Deleted]

A141c. The auditor's understanding of the relevant aspects of the information system may be obtained in various ways and may include:

- Inspection of policy or process manuals or other documentation of the entity's information system;
- Inquiries of relevant personnel about the procedures used to initiate, record, process and report transactions or about the entity's financial reporting process; or
- Observation of the performance of the policies or procedures by entity's personnel.

- Selecting transactions and tracing them through the applicable process in the information system.

Inquiry alone, however, is not sufficient for such purposes.

A141d. [Previously para. A154 - deleted]

#### Automated Tools and Techniques

A141e. The auditor may also use automated techniques by obtaining direct access to, or a digital download from, the databases in the entity's information system that store the accounting records of transactions. By using this information, the auditor may confirm the understanding obtained about how transactions flow through the information system by tracing journal entries, or other digital records related to a particular transaction, or an entire population of transactions, from initiation in the accounting records through to recording in the general ledger. Analysis of complete or large sets of transactions may also result in the identification of variations from the normal, or expected, processing procedures for these transactions, which may result in the identification of risks of material misstatement.

#### Information Obtained from Outside of the General and Subsidiary Ledgers

A142. Financial statements may contain information that is obtained from outside of the general and subsidiary ledgers. Examples of such information that the auditor may consider include:

- Information obtained from lease agreements relevant to disclosures in the financial statements.
- Information disclosed in the financial statements that is produced by an entity's risk management system.
- Fair value information produced by management's experts and disclosed in the financial statements.
- Information disclosed in the financial statements that has been obtained from models, or from other calculations used to develop accounting estimates recognized or disclosed in the financial statements, including information relating to the underlying data and assumptions used in those models, such as:
  - Assumptions developed internally that may affect an asset's useful life; or
  - Data such as interest rates that are affected by factors outside the control of the entity.
- Information disclosed in the financial statements about sensitivity analyses derived from financial models that demonstrates that management has considered alternative assumptions.
- Information recognized or disclosed in the financial statements that has been obtained from an entity's tax returns and records.
- Information disclosed in the financial statements that has been obtained from analyses prepared to support management's assessment of the entity's ability to continue as a going concern, such as disclosures, if any, related to events or conditions that have been identified that may cast significant doubt on the entity's ability to continue as a going concern.<sup>26</sup>

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<sup>26</sup> See paragraphs 19–20 of ISA 570 (Revised), *Going Concern*



A143. Certain amounts or disclosures in the entity's financial statements (such as disclosures about credit risk, liquidity risk, and market risk) may be based on information obtained from the entity's risk management system. However, the auditor is not required to understand all aspects of the risk management system, and uses professional judgment in determining the necessary understanding.

#### Understanding the Entity's Use of Information Technology in the Information System

##### Why Does the Auditor Understand the IT Environment Relevant to the Information System

A144. The auditor's understanding of the information system includes the IT environment relevant to the flows of transactions and processing of information in the entity's information system because the entity's use of IT applications or other aspects in the IT environment may give rise to risks arising from the use of IT.

A144a. The understanding of the entity's business model and how it integrates the use of IT may provide useful context to the nature and extent of IT expected in the information system.

A144b. The auditor's understanding of the IT environment may focus on identifying, and understanding the nature and number of, the specific IT applications and other aspects of the IT environment that are relevant to the flows of transactions and processing of information in the information system. Changes in the flow of transactions or information within the information system may result from program changes to IT applications involved in processing those transactions or information.

A145. [Moved to **Appendix 5**]

A146. The auditor may identify the IT applications and supporting IT infrastructure concurrently with the auditor's understanding of how information relating to significant classes of transactions, account balances and disclosures flows into, through and out the entity's information system.

A147. [Partly moved to **Appendix 5**] [Rest moved]

A148. [Deleted]

[Part of Para. A148 moved to **Appendix 5**]

A149. [Moved to **Appendix 5**]

A150. [Moved to **Appendix 5**]

A151. [Moved]

A152. [Moved]

A153. [Moved]

A154. [Moved]

A155. [Moved]

#### Evaluating Whether the Relevant Aspects of the Information System Support the Preparation of the Entity's Financial Statements

A155a. The auditor's evaluation of whether the relevant aspects of the entity's information system and communication supports the preparation of the financial statements is undertaken using the information from the understanding of the entity's information system and communication obtained.

A156. [Deleted]

A157. [Deleted]

A158. [Moved to **Appendix 3**]

#### Scalability

A158a. In larger, more complex entities information the auditor may consider when understanding the entity's communication may come from policy manuals and financial reporting manuals.

A159. In less complex entities, communication may be less structured (e.g., formal manuals may not be used) and due to fewer levels of responsibility and management's greater visibility and availability. Regardless of the size of the entity, open communication channels help ensure that exceptions are reported and acted on.

*Control Activities* (Ref: Para. 39)

A160. [First part deleted] [Rest moved]

#### Scalability

A161. Controls in the control activities component for less complex entities are likely to be similar to those in larger entities, but the formality with which they operate may vary. Further, in less complex entities, more controls may be directly applied by management.

Example:

Management's sole authority for granting credit to customers and approving significant purchases can provide strong control over important account balances and transactions.

A161a. It may be less practicable to establish segregation of duties in smaller and less complex entities that have fewer employees. However, in an owner-managed entity, the owner-manager may be able to exercise more effective oversight through direct involvement than in a larger entity, which may compensate for the generally more limited opportunities for segregation of duties. Although, as also explained in ISA 240, domination of management by a single individual can be a potential control deficiency since there is an opportunity for management override of controls.<sup>27</sup>

#### Types of Controls in Control Activities

A161b. Regardless of whether controls are within the IT environment or manual systems, controls may have various objectives and may be applied at various organizational and functional levels. Examples of controls in the control activities component include authorizations and approvals, reconciliations, verifications (such as edit and validation checks or automated calculations), segregation of duties, and physical or logical controls, including those addressing safeguarding of assets.

A162. [Moved to guidance]

A163. [Moved to **Appendix 3**]

A164. [Moved]

A165. Controls in the control activities component may also include controls established by management that address risks of material misstatement related to disclosures not being prepared in accordance with the applicable financial reporting framework. Such controls may relate to information included in the financial statements that is obtained from outside of the general and subsidiary ledgers.

Identifying controls that address risks of material misstatement at the assertion level

A166. Controls are required to be identified when such controls meet one or more of the criteria included in paragraph 39. However, when multiple controls each achieve the same objective, it is unnecessary to identify each of the controls related to such objective.

#### Scalability

A167. Controls that address risks of material misstatement at the assertion level that are expected to be relevant for all audit's controls over journal entries because the manner in which an entity incorporates information from transaction processing into the general ledger ordinarily involves the use of journal entries, whether standard or non-standard, or automated or manual. The extent to which other controls are relevant may vary based on the nature of the entity and the auditor's planned approach to further audit procedures.

**Example:**

In an audit of a less complex entity, the entity's information system may not be complex and the auditor may not plan to rely on the operating effectiveness of controls. Further, the auditor may not have identified any significant risks or any other risks of material misstatement for which it is necessary for the auditor to evaluate the design of controls and determine that they have been implemented. In such an audit, the auditor may determine that there are no identified controls other than the entity's controls over journal entries.

A168. [Moved]

Controls that address significant risks (Ref: Para. 39(a))

A169. [Moved]

A170. Regardless of whether the auditor intends to test the operating effectiveness of controls that address significant risks, the understanding obtained about management's approach to addressing those risks may inform the design and performance of substantive procedures responsive to significant risks as required by ISA 330.<sup>28</sup> Although risks relating to significant non-routine or judgmental matters are often less likely to be subject to routine controls, management may have other responses intended to deal with such risks. Accordingly, the auditor's understanding of whether the entity has designed and implemented controls for significant risks arising from non-routine or judgmental matters includes whether and how management responds to the risks. Such responses might include:

- Controls such as a review of assumptions by senior management or experts.
- Documented processes for accounting estimations.

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<sup>28</sup> ISA 330, paragraph 21

- Approval by those charged with governance.

Example

Where there are one-off events such as the receipt of a notice of a significant lawsuit, consideration of the entity's response may include such matters as whether it has been referred to appropriate experts (such as internal or external legal counsel), whether an assessment has been made of the potential effect, and how it is proposed that the circumstances are to be disclosed in the financial statements.

A171. [Moved]

A172. ISA 240<sup>29</sup> requires the auditor to identify controls that address risks of material misstatement due to fraud and explains that it is important for the auditor to obtain an understanding of the controls that management has designed, implemented and maintained to prevent and detect fraud. In identifying these controls, the auditor may learn, for example, that management has consciously chosen to accept the risks associated with a lack of segregation of duties.

A173. [Moved]

Controls over journal entries (Ref: Para. 39(b))

A174. [Deleted]

A175. [Deleted and moved (part)]

A175a. In manual general ledger systems, non-standard journal entries may be identified through inspection of ledgers, journals, and supporting documentation. When automated procedures are used to maintain the general ledger and prepare financial statements, such entries may exist only in electronic form and may therefore be more easily identified through the use of automated techniques.

Example:

In the audit of a less complex entity, the auditor may be able to extract a total listing of all journal entries into a simple spreadsheet. It may then be possible for the auditor to sort the journals by applying a variety of filters such as dollar amount, name of the journal preparer or reviewer, entries that gross up the balance sheet and income statement only, or to view the listing by the date the journal entry was posted to the general ledger, to assist the auditor in designing their response to the risks identified relating to journal entries.

Controls that are Necessary for the Auditor to Identify Due to Assessments of Related Risks of Material Misstatement (Ref: Para. 39(c))

A175b. The extent to which other controls that are necessary to be identified to achieve the objectives in paragraph 17(a) and (b) because of where the assessments of the related risks of material misstatement at the assertion level fall on the spectrum of inherent risk is a matter of the auditor's professional judgment. The auditor's judgment about whether it is appropriate to identify such controls in order to provide a basis for the design and performance of further audit procedures is influenced by where on the spectrum of inherent risk the assessed risk falls, in particular for those

<sup>29</sup> ISA 240, paragraphs 27 and A32.

risks of material misstatement that are closer to the upper end of the spectrum of inherent risk but have not been identified as significant risks.

A175c. The higher the risk is assessed on the spectrum of inherent risk, the more persuasive the audit evidence needs to be. As explained in ISA 330,<sup>30</sup> obtaining more persuasive evidence may involve obtaining evidence that is more relevant or reliable. The auditor's understanding of controls contributes to the audit evidence obtained for these risks and this understanding may further assist the auditor in designing further audit procedures to obtain more relevant and reliable audit evidence.

Testing of operating effectiveness of controls (Ref: Para. 39(d))

A175d. The auditor determines whether there are any risks of material misstatement at the assertion level for which it is not possible or practicable to obtain sufficient appropriate audit evidence through substantive procedures alone. The auditor is required, in accordance with ISA 330,<sup>31</sup> to design and perform tests of relevant controls that address such risks of material misstatement when substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level. As a result, when such controls exist that address these risks, they are required to be identified.

A176. When the auditor voluntarily intends to take into account the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures, such controls are required to be identified because ISA 330<sup>32</sup> requires the auditor to design and perform tests of those controls.

Example:

The auditor may plan to test controls over routine classes of transactions because such testing may be more effective or efficient for large volumes of homogenous transactions.

A177. The auditor's intentions to test the operating effectiveness of controls may also be influenced by the identified risks of material misstatement at the financial statement level. For example, if deficiencies are identified related to the control environment, this may affect the auditor's overall expectations about the operating effectiveness of direct controls.

A178. The auditor may plan to test the operating effectiveness of controls over the completeness and accuracy of information produced by the entity (e.g., controls over the preparation of system-generated reports) when the auditor intends to take into account the operating effectiveness of those controls in designing and performing further audit procedures to determine the reliability of that information for its use as audit evidence. The auditor may also plan to test the operating effectiveness of controls relating to operations and compliance objectives when they relate to data the auditor evaluates or uses in applying audit procedures.

A179. [Moved]

[Former bullets of para. A179 – deleted]

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<sup>30</sup> ISA 330, paragraph A19

<sup>31</sup> ISA 330, paragraph 8

<sup>32</sup> ISA 330, paragraph 8(a)

Identifying IT Applications and Other Aspects of the IT Environment , Risks Arising from the Entity's Use of IT and General IT Controls (Ref: Para 40)

**Appendix 5** includes example characteristics of IT applications, and guidance related to those characteristics, that may be relevant in identifying IT applications subject to risks arising from the use of IT.

Why the auditor identifies risks arising from the use of IT and general IT controls related to identified IT applications and other aspects of the IT environment

A179a. Understanding the risks arising from the use of IT and the general IT controls implemented by the entity to address those risks may affect:

- The auditor's decision about whether to test the operating effectiveness of controls to address risks of material misstatement at the assertion level;

Example:

When general IT controls are not designed effectively or appropriately implemented to address risks arising from the use of IT (e.g., unauthorized program changes or unauthorized access to IT applications), this may affect the auditor's decision to rely on automated controls within the affected IT applications.

- The auditor's assessment of control risk at the assertion level;

Example:

The ongoing operating effectiveness of an information processing control may depend on certain general IT controls that prevent or detect unauthorized program changes to the IT information processing control (i.e. program change controls over the related IT application). In such circumstances, the expected operating effectiveness (or lack thereof) of the general IT control may affect the auditor's assessment of control risk (e.g., control risk may be higher when such general IT controls are expected to be ineffective or if the auditor does not plan to test the general IT controls).

- The auditor's strategy for testing information produced by the entity that is produced by or involves information from the entity's IT applications;

Example:

When information produced by the entity to be used as audit evidence is produced by IT applications, the auditor may determine to controls over system-generated reports, including identification and testing of the general IT controls that address risks of inappropriate or unauthorized program changes to the reports.

- The auditor's assessment of inherent risk at the assertion level; or

Example:

When there are significant or extensive programming changes to an IT application to address new or revised reporting requirements of the applicable financial reporting framework, this may be an indicator of the complexity of the new requirements and their effect on the entity's financial statements. When such extensive programming changes occur, the IT application is also likely to be subject to risks arising from the use of IT.

- The design of further audit procedures.

Example:

Information processing controls depend on general IT controls, the auditor may determine to test the operating effectiveness of the general IT controls, which will then require the design of tests of control procedures for those general IT controls. If, in the same circumstances, the auditor determines not to test the operating effectiveness of the general IT controls, or the general IT controls are expected to be ineffective, the related risks arising from the use of IT may need to be addressed through the design of substantive procedures.

#### Identifying IT applications that are subject to risks arising from the use of IT

A180. For the IT applications relevant to the information system, understanding the nature and complexity of the specific IT processes and general IT controls that the entity has in place may assist the auditor in determining which IT applications the entity is relying upon to accurately process and maintain the integrity of information in the entity's information system. Such IT applications may be subject to risks arising from the use of IT.

A180a. Identifying the IT applications that are subject to risks arising from the use of IT involves taking into account controls identified by the auditor in accordance with paragraph 39 because such controls may involve the use of IT or rely on IT. The auditor may focus on whether an IT application includes automated controls that management is relying on and that the auditor has identified, including controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence. The auditor may also consider how information is stored and processed in the information system relating to significant classes of transactions, account balances and disclosures and whether management is relying on general IT controls to maintain the integrity of that information.

A180b. The automated controls identified by the auditor may include controls related to system-generated reports, in which case the IT applications that produce those reports may be subject to risks arising from the use of IT. In other cases, the auditor may not plan to rely on system-generated reports and plan to directly test the inputs and outputs of such reports, in which case the auditor may not identify the related IT applications as being subject to risks arising from IT.

#### Scalability

A180c. The extent of the auditor's understanding of the IT processes, including the extent to which the entity has general IT controls in place, will vary with the nature and the circumstances of the entity and its IT environment, as well as based on the nature and extent of controls identified by the auditor.

The number of IT applications that are subject to risks arising from the use of IT also will vary based on these factors.

Examples:

- An entity that uses commercial software and does not have access to the source code to make any program changes is unlikely to have a process for program changes, but may have a process or procedures to configure the software (e.g., the chart of accounts, reporting parameters or thresholds). In addition, the entity may have a process or procedures to manage access to the application (e.g., a designated individual with administrative access to the commercial software). In such circumstances, the entity is unlikely to have or need general IT controls.
- In contrast, a larger entity may rely on IT to a great extent and the IT environment may involve multiple IT applications and the IT processes to manage the IT environment may be complex (e.g., dedicated IT department exists that develops and implements program changes and manages access rights), including that the entity has implemented formalized general IT controls over its IT processes.
- When management is not relying on automated controls or general IT controls to process transactions or maintain the data, and the auditor has not identified any automated controls or other information processing controls (or any that depend on general IT controls), the auditor may plan to directly test any information produced by the entity involving IT and may not identify any IT applications that are subject to risks arising from the use of IT.
- When management relies on an IT application to process or maintain data and the volume of data is significant, and management relies upon the IT application to perform automated controls that the auditor has also identified, the IT application is likely to be subject to risks arising from the use of IT.

A180d. When an entity has greater complexity in its IT environment, identifying the IT applications and other aspects of the IT environment, determining the related risks arising from the use of IT, and identifying general IT controls is likely to require the involvement of team members with specialized skills in IT. Such involvement is likely to be essential, and may need to be extensive, for complex IT environments.

A181. [Moved]

A182. [Moved]

A183. [Moved to **Appendix 5**]

A184. [Moved to **Appendix 5**]

A185. [Moved to **Appendix 5**]

A186. [Moved to **Appendix 5**]

A187. [Moved to **Appendix 5**]



#### Identifying other aspects of the IT environment that are subject to risks arising from the use of IT

A188. The other aspects of the IT environment that may be subject to risks arising from the use of IT include the network, operating system and databases, and in certain circumstances interfaces between IT applications. When the auditor does not identify IT applications, other aspects of the IT environment are also not identified. When the auditor has identified IT applications, whether the other aspects of the IT environment are identified varies based on the extent to which such aspects support and interact with the identified IT applications. [*Rest moved to Appendix*]

#### Identifying Risks Arising from the Use of IT and General IT Controls

A188a. In identifying the risks arising from the use of IT, the auditor may consider the nature of the identified IT application or other aspect of the IT environment and the reasons for it being subject to risks arising from the use of IT. For some identified IT applications or other aspects of the IT environment, the auditor may identify specific risks arising from the use of IT that relate primarily to unauthorized access or unauthorized program changes. In the case of identified databases or data warehouses, the auditor may be focused on the risk of inappropriate changes to the data through direct database access and the ability to directly manipulate information.

A189. The extent and nature of the risks arising from the use of IT vary depending on the nature and characteristics of the identified IT applications and other aspects of the IT environment. Specific IT risks may result when the entity uses external or internal service providers for identified aspects of its IT environment (e.g., outsourcing the hosting of its IT environment to a third party or using a shared service center for central management of IT processes in a group). Specific IT risks may also be identified related to cybersecurity. It is more likely that there will be more IT risks arising from the use of IT when the volume or complexity of automated application controls is higher and management is placing greater reliance on those controls for effective processing of transactions or the effective maintenance of the integrity of underlying information. [*Deleted as now covered by reference to appendix*]

A190. [*Moved to **Appendix 5***].

A191. [*Moved*]

A192. [*Moved to **Appendix 5***]

A193. [*Partly moved to **Appendix 6***]

#### Evaluating the Design, and Determining Implementation of, Identified Controls in the Control Activities Component (Ref: Para 42)

A194. Evaluating the design of an identified control involves the auditor's consideration of whether the control, individually or in combination with other controls, is capable of effectively preventing, or detecting and correcting, material misstatements (i.e., the control objective). The auditor determines the implementation of an identified control by determining that the control exists and that the entity is using it. There is little point in the auditor assessing the implementation of a control that is not designed effectively. Therefore, the auditor evaluates the design of a control is considered first. An improperly designed control may represent a significant control deficiency.

A195. In making risk assessments, the auditor may identify controls that are likely to prevent, or detect and correct, material misstatement in specific assertions. Generally, it is useful to obtain an understanding

of controls and relate them to risks of material misstatement in the context of processes and, when applicable, IT applications in which they exist. [*Rest moved to and reworded in para. A196a*]

A196. Many identified controls may be direct controls that therefore directly address risks of material misstatement at the assertion level embodied in a particular significant class of transactions or account balance.

Example:

The controls that an entity has established to ensure that its personnel are properly counting and recording the annual physical inventory relate directly to the risks of material misstatement relevant to the existence and completeness assertions for the inventory account balance.

A197. The more indirect the relationship between controls that support other controls and the control that is being considered, the less effective that control may be in preventing, or detecting and correcting, misstatements related to the risk of material misstatement.

Example:

A sales manager's review of a summary of sales activity for specific stores by region ordinarily is only indirectly related to the risks of material misstatement relevant to the completeness assertion for sales revenue. Accordingly, it may be less effective in reducing those risks than controls more directly related thereto, such as matching shipping documents with billing documents. Similarly, a general IT control alone is typically not sufficient to address a risk of material misstatement at the assertion level.

A198. Risk assessment procedures to obtain audit evidence about the design and implementation of identified controls in the control activities component may include:

- Inquiring of entity personnel.
- Observing the application of specific controls.
- Inspecting documents and reports.

Inquiry alone, however, is not sufficient for such purposes.

A198a. The auditor may conclude that a control, which is effectively designed and implemented, may be appropriate to test in order to take its operating effectiveness into account in designing substantive procedures. When the auditor plans to test a control, the information obtained about the extent to which the control addresses the risk(s) of material misstatement is an input to the auditor's control risk assessment at the assertion level.

A199. Evaluating the design and determining the implementation of identified controls in the control activities component is not sufficient to test their operating effectiveness, unless a control is an automated control and the auditor has identified and tested general IT controls that provide for the consistent operation of the automated control. Obtaining audit evidence about the implementation of a manual control at a point in time does not provide audit evidence about the operating effectiveness of the control at other times during the period under audit. Tests of the operating effectiveness of controls, including tests of indirect controls, are further described in ISA 330.<sup>33</sup>

<sup>33</sup> ISA 330, paragraphs 8–11

A200. When the auditor does not plan to test the operating effectiveness of identified controls, the auditor's understanding may still affect the design of the nature, timing and extent of substantive audit procedures that are responsive to the related risks of material misstatement.

Example:

The results of these risk assessment procedures may inform the auditor's consideration of possible deviations in a population when designing audit samples.

*Control Deficiencies Within the System of Internal Control* (Ref: Para. 43)

A200a. In performing the evaluations of the relevant aspects of each of the components of the system of internal control, the auditor may identify weaknesses or determine that the system of internal control is not appropriate for the nature and circumstances of the entity. These may be indicators that there are control deficiencies.

A200b. The auditor also considers whether the control environment supports the operation of controls within the other components of the entity's system of internal control (as explained in paragraph A104a).

A200c. The auditor uses professional judgment in determining whether a deficiency represents a significant control deficiency<sup>34</sup>

Example:

Circumstances that may indicate a significant control deficiency exists include matters such as:

- The identification of fraud of any magnitude that involves senior management;
- Identified internal processes that are inadequate relating to the reporting and communication of deficiencies noted by internal audit;
- Previously communicated deficiencies that are not corrected by management in a timely manner;
- Failure by management to respond to significant risks, for example, by not implementing controls over significant risks; and
- The restatement of previously issued financial statements.

## **Identifying and Assessing the Risks of Material Misstatement**

### *Why the Auditor Identifies and Assesses the Risks of Material Misstatement*

A201. Risks of material misstatement are identified and assessed by the auditor in order to determine the nature, timing and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. This evidence enables the auditor to express an opinion on the financial statements at an acceptably low level of audit risk.

A201a. Information gathered by performing risk assessment procedures is used as audit evidence to provide the basis for the identification and assessment of the risks of material misstatement. The

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<sup>34</sup> ISA 265, paragraph 8

audit evidence obtained when evaluating the design of identified controls in the control activities component and determining whether those controls have been implemented, is also used as audit evidence to support the risk assessment. The basis for the risk assessment also provides the basis for the auditor to design overall responses to address the assessed risks of material misstatement at the financial statement level, as well as the nature, timing and extent of further audit procedures to be performed in accordance with ISA 330.

A202. [Moved to FAQ]

A202a. Identifying the risks of material misstatement also provides the basis for the auditor's determination of relevant assertions, which assists the auditor's determination of the significant classes of transactions, account balances and disclosures.

### *Assertions*

#### *Why the Auditor Uses Assertions*

A202b. Management makes assertions about the entity's classes of transactions, account balances and disclosures when representing that the financial statements are prepared in accordance with the applicable financial reporting framework. In identifying and assessing the risks of material misstatement, the auditor uses assertions to consider the different types of potential misstatements that may occur. Assertions for which the auditor has identified related risks of material misstatement are relevant assertions.

#### *The Use of Assertions*

A203. In identifying and assessing the risks of material misstatement, the auditor may use the assertions as described in paragraph A204(a)–(b) below or may express them differently provided all aspects described below have been covered. The auditor may choose to combine the assertions about classes of transactions and events, and related disclosures, with the assertions about account balances, and related disclosures.

A204. Assertions used by the auditor in considering the different types of potential misstatements that may occur may fall into the following categories:

- (a) Assertions about classes of transactions and events, and related disclosures, for the period under audit:
  - (i) Occurrence—transactions and events that have been recorded or disclosed, have occurred, and such transactions and events pertain to the entity.
  - (ii) Completeness—all transactions and events that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.
  - (iii) Accuracy—amounts and other data relating to recorded transactions and events have been recorded appropriately, and related disclosures have been appropriately measured and described.
  - (iv) Cutoff—transactions and events have been recorded in the correct accounting period.
  - (v) Classification—transactions and events have been recorded in the proper accounts.

- (vi) Presentation—transactions and events are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.
- (b) Assertions about account balances, and related disclosures, at the period end:
- (i) Existence—assets, liabilities, and equity interests exist.
  - (ii) Rights and obligations—the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.
  - (iii) Completeness—all assets, liabilities and equity interests that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.
  - (iv) Accuracy, valuation and allocation—assets, liabilities, and equity interests have been included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments have been appropriately recorded, and related disclosures have been appropriately measured and described.
  - (v) Classification—assets, liabilities and equity interests have been recorded in the proper accounts.
  - (vi) Presentation—assets, liabilities and equity interests are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

A205. The assertions described in paragraph A204(a)–(b) above, adapted as appropriate, may also be used by the auditor in considering the different types of misstatements that may occur in disclosures not directly related to recorded classes of transactions, events, or account balances.

Example:

The entity may be required to describe its exposure to risks arising from financial instruments, including how the risks arise; the objectives, policies and processes for managing the risks; and the methods used to measure the risks.

#### Considerations Specific to Public Sector Entities

A206. When making assertions about the financial statements of public sector entities, in addition to those assertions set out in paragraph A204(a)–(b), management may often assert that transactions and events have been carried out in accordance with law, regulation or other authority. Such assertions may fall within the scope of the financial statement audit.

#### Why the Auditor Identifies and Assesses Risks of Material Misstatement at the Financial Statement and Assertion Levels

A206a. The auditor identifies risks of material misstatement at the financial statement level in order to determine whether the risks have a pervasive effect on the financial statements that would require

an overall response in accordance with ISA 330.<sup>35</sup> In addition, risks of material misstatement at the financial statement level may also affect individual assertions, and identifying these risks may assist the auditor in assessing risks of material misstatement at the assertion level and in designing further audit procedures to address the identified risks.

A206b. The evaluation of whether risks identified relate pervasively to the financial statements supports the auditor's assessment of the risks of material misstatement at the financial statement level

#### Professional Skepticism

A206c. In identifying the risks of material misstatement, the auditor considers whether sufficient understanding about the entity and its environment, the applicable financial reporting framework and the entity's system of internal control has been obtained to be able to identify the risks of material misstatement, as well as whether there is any evidence that is contradictory that may indicate a risk of material misstatement.

#### *Risks of Material Misstatement at the Financial Statement Level*

A207. Risks of material misstatement at the financial statement level refer to risks that relate pervasively to the financial statements as a whole, and potentially affect many assertions. Risks of this nature are not necessarily risks identifiable with specific assertions at the class of transactions, account balance, or disclosure level. Rather, they represent circumstances that may pervasively increase the risks of material misstatement at the assertion level.

**Example:**

The entity faces operating losses and liquidity issues and is reliant on funding that has not yet been secured. In such a circumstance, the auditor determines that the going concern basis of accounting gives rise to a risk of material misstatement at the financial statement level. In this situation, the accounting framework may need to be applied using a liquidation basis which would affect all assertions pervasively.

A207a. The auditor's identification and assessment of risks of material misstatement at the financial statement level is influenced by the auditor's understanding of the entity's system of internal control, in particular the auditor's understanding of the control environment, the entity's risk assessment process and the entity's process to monitor the system of internal control and the outcome of the related evaluations required by paragraphs 28 and 30, and any control deficiencies identified in accordance with paragraph 43. In particular, risks at the financial statement level may arise from deficiencies in the control environment or from external events or conditions, such as declining economic conditions.

A207b. Risks of material misstatement due to fraud may be particularly relevant to the auditor's consideration of the risks of material misstatement at the financial statement level.

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<sup>35</sup> ISA 330, paragraph 5

Example:

The auditor understands from inquiries of management that the entity's financial statements are to be used in discussions with their bank in order to secure further financing to maintain working capital. The auditor determines that there is a greater potential for misstatement based on susceptibility to management bias or misappropriation of assets. (i.e. the financial statements may be materially misstated, as management might engage in fraudulent financial reporting, such as overstatement of assets and revenue and under-statement of liabilities and expenses to ensure that financing will be obtained).

A207c. The auditor's understanding and evaluations of the control environment and other components of the system of internal control may raise doubts about the auditability of the financial statements to be audited, such that it may affect the auditor's expectations about the ability to obtain audit evidence to support the audit opinion or be cause for withdrawal from the engagement.

Example:

- In evaluating the entity's control environment, the auditor has concerns about the integrity of the entity's management, which may be so serious as to cause the auditor to conclude that the risk of management misrepresentation in the financial statements is such that an audit cannot be conducted.
- In evaluating the entity's information system and communication, the auditor determines that significant changes in the IT environment have been poorly managed, with little oversight from management and those charged with governance. The auditor concludes that there are significant concerns about the condition and reliability of an entity's records. In such circumstances, the auditor may determine that it is unlikely that sufficient appropriate audit evidence will be available to support an unmodified opinion on the financial statements.

A207d. ISA 705 (Revised)<sup>36</sup> establishes requirements and provides guidance in determining whether there is a need for the auditor to express a qualified opinion or disclaim an opinion or, as may be required in some cases, to withdraw from the engagement where withdrawal is possible under applicable law or regulation.

*Risks of Material Misstatement at the Assertion Level*

**Appendix 2** sets out examples, in the context of the inherent risk factors, of events and conditions that may indicate susceptibility to misstatement that may be material.

A208. Risks of material misstatements that do not relate pervasively to the financial statements are risks of material misstatement at the assertion level. The identification of risks of material misstatement at the assertion level is performed before consideration of any related controls, and may be based on a preliminary assessment of inherent risk (i.e., the auditor considers those risks for which a misstatement could be material, and the likelihood that the risk could occur).<sup>37</sup>

<sup>36</sup> ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*

<sup>37</sup> Proposed ISA 200, paragraph A15a [this links to the new proposed ISA 200 Conforming Amendment – see paragraph 21 of Agenda Item 2]

A209. While obtaining the understanding of the entity and its environment, and how the applicable financial reporting framework is applied, the auditor considers where there are inherent risk factors related to the entity's events and conditions, which may then assist the auditor with identifying where there could be risks of material misstatement related to the classes of transactions, account balances and disclosures.

#### Considerations Specific to Public Sector Entities

A210. For public sector entities, the identification of risks at the financial statement level may include consideration of matters related to the political climate, public interest and program sensitivity.

Relevant Assertions and Significant Classes of Transactions, Account Balances and Disclosures (Ref: Para. 46)

#### Why Relevant Assertions and Significant Classes of Transactions, Account Balances and Disclosures are Determined

A211. The assertions to which identified risks of material misstatement relate are relevant assertions, and the classes of transactions, account balances and disclosures to which the relevant assertions relate are significant classes of transactions, account balances and disclosures. Significant classes of transactions, account balances and disclosures are determined to assist the auditor in identifying where to focus further audit procedures in accordance with paragraph 7 of ISA 330. In determining the relevant assertions, the auditor considers the information gathered from the auditor's risk assessment procedures about the identified risks of material misstatement and the assertions that they may affect.

A212. [Deleted]

#### Automated Tools and Techniques

A213. The auditor may use automated techniques to assist in the identification of significant classes of transactions and account balances.

#### Examples:

An entire population of transactions may be analyzed to identify their nature, source, size and volume. By applying automated techniques, the auditor may, for example, identify that an account with a zero balance at period end was comprised of numerous offsetting transactions and journal entries occurring during the period thus indicating that the account balance or class of transactions may be significant (e.g., a payroll clearing account). This same payroll clearing account may also identify expense reimbursements to management (and other employees), which could be a significant disclosure due to these payments being made to related parties.

By mapping the flow of an entire population of revenue transactions, the auditor may identify a significant class of transaction in revenue that had not previously been identified by the auditor.

#### Disclosures that May be Significant

A214. Significant disclosures include both quantitative and qualitative disclosures for which there is one or more relevant assertions. Examples of disclosures that have qualitative aspects and that may have



relevant assertions and may therefore be considered significant by the auditor include disclosures about:

- Liquidity and debt covenants of an entity in financial distress.
- Events or circumstances that have led to the recognition of an impairment loss.
- Key sources of estimation uncertainty, including assumptions about the future.
- The nature of a change in accounting policy, and other relevant disclosures required by the applicable financial reporting framework, where, for example, new financial reporting requirements are expected to have a significant impact on the financial position and financial performance of the entity.
- Share-based payment arrangements, including information about how any amounts recognized were determined, and other relevant disclosures.
- Related parties, and related party transactions.
- Sensitivity analysis, including the effects of changes in assumptions used in the entity's valuation techniques intended to enable users to understand the underlying measurement uncertainty of a recorded or disclosed amount.

*Assessing Risks of Material Misstatement at the Financial Statement Level* (Ref: Para. 47)

A215. Because risks of material misstatement at the financial statement level have a pervasive effect on the financial statements, it may not be possible to identify the specific assertions that are more susceptible to the risk (e.g., risk of management override of controls). In other cases, a number of assertions may be identified as susceptible to the risk, and which may therefore affect the auditor's risk identification and assessment of risks of material misstatement at the assertion level.

A216. [Moved]

A217. [Moved]

A218. [Moved]

A219. [Moved]

A220. [Moved]

*Assessing Risks of Material Misstatement at the Assertion Level*

Assessing Inherent Risk (Ref: Para. 48)

Assessing the Likelihood and Magnitude of the Risks of Material Misstatement at the Assertion Level (Ref: Para: 48(a))

Why the Likelihood and Magnitude of Risks of Material Misstatement are Assessed at the Assertion Level

A220a. The auditor assesses the likelihood and magnitude of material misstatement for identified risks of material misstatement to determine where on the spectrum of inherent risk the identified risk is assessed, which informs the auditor's design of further audit procedures to address the risk. Assessing the inherent risk of identified risks of material misstatement also assists the auditor in determining significant risks.

## Assessing the Risks of Material Misstatement at the Assertion level

A221. The degree to which events or conditions relating to significant classes of transactions, account balances and disclosures are subject to, or affected by, the inherent risk factors affects the degree to which such events and conditions are susceptible to misstatement. The inherent risk factors influence the auditor's assessment of the likelihood and magnitude of misstatement for the identified risks of material misstatement at the assertion level. The greater the degree to which a class of transactions, account balance or disclosures is susceptible to material misstatement, the higher the inherent risk assessment is likely to be. Considering the influence of the inherent risk factors assists the auditor in designing a more precise response to an assessed risk of material misstatement.

### Spectrum of Inherent Risk

A221a. In assessing the risks of material misstatement, the auditor uses professional judgment in assessing the likelihood and magnitude of material misstatement.

A221b. For all audit engagements, across the risks of material misstatement at the assertion level, inherent risk varies on a range from lower to higher. The assessed inherent risk relating to a particular risk of material misstatement at the assertion level represents a judgment within that range. The judgment about where in the range the risk of material misstatement is assessed takes into account the assessed likelihood and magnitude of the material misstatement, as well as the inherent risk factors, and may vary based on the nature, size and complexity of the entity.

A222. In assessing the risk of material misstatement at the assertion level, the auditor considers the magnitude and likelihood of a material misstatement separately. In considering the magnitude of a misstatement, the auditor considers the qualitative and quantitative aspects of the possible misstatement (i.e., misstatements in assertions about classes of transactions, account balances or disclosures may be judged to be material due to size, nature or circumstances).

A222a. The auditor uses the relative degrees of the likelihood and magnitude of a possible misstatement determine to assist in determining where on the spectrum of inherent risk (i.e., the range) the risk of misstatement is assessed. The higher the combination of likelihood and magnitude, the higher the inherent risk; the lower the combination of likelihood and magnitude, the lower the inherent risk. A higher inherent risk assessment may also arise from different combinations of likelihood and magnitude, for example a higher risk assessment could result from a lower likelihood but a very high magnitude.

A223. [*Moved*]

A224. [*Deleted*]

A225. In order to develop appropriate strategies for responding to risks of material misstatement, the auditor may designate risks of material misstatement within relative categories along the spectrum of inherent risk, based on their assessment of inherent risk. These relative categories may be described in different ways. Regardless of the method of categorization used, the auditor's assessment of inherent risk is appropriate when the design and implementation of further audit procedures to address the identified risks of material misstatement at the assertion level is responsive to the assessment of inherent risk and the reasons for that assessment.

## Pervasive Risks of Material Misstatement at the Assertion Level

A226. In assessing the identified risks of material misstatement at the assertion level, the auditor may conclude that some risks of material misstatement relate more pervasively to the financial statements as a whole and potentially affect many assertions, in which case the auditor may update the identification of risks of material misstatement at the financial statement level.

A227. In circumstances in which risks of material misstatement are identified as financial statement level risks due to their pervasive effect on a number of assertions, and are identifiable with specific assertions, the auditor may consider the effect of those risks when assessing the inherent risk for risks of material misstatement at the assertion level. (Ref: Para. 48(b))

## Considerations specific to public sector entities

A228. In exercising professional judgment as to the assessment of the risk of material misstatement, public sector auditors may consider the complexity of the regulations and directives, and the risks of non-compliance with authorities.

## Significant Risks (Ref: Para. 49)

### Why Significant Risks are Determined and the Implications for the Audit

A228a. Significant risks are determined so that the auditor's responses for the highest risks are appropriate in the circumstances. ISA 330 describes the consequences for further audit procedures of identifying a risk as significant. When a risk is assessed as a significant risk, the implications for the audit include the design and implementation of an appropriate response to address the assessed risk, which may include for example the use of more experienced engagement team members, including those with specialized skills, to perform audit procedures or audit work may involve the use of experts. In addition, the ISAs set out required responses, including:

- Controls that address significant risks are required to be identified in accordance with paragraph 39, with a requirement to evaluate whether the control has been designed effectively and implemented in accordance with paragraph 42.
- ISA 330 requires controls that address significant risks to be tested in the current period (when the auditor intends to rely on the operating effectiveness of such controls) and substantive procedures to be planned and performed that are specifically responsive to the identified significant risk.<sup>38</sup>
- ISA 330 requires the auditor to obtain more persuasive audit evidence the higher the auditor's assessment of risk.<sup>39</sup>
- ISA 260 (Revised) requires communicating with those charged with governance about the significant risks identified by the auditor.<sup>40</sup>

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<sup>38</sup> ISA 330, paragraphs 15 and 21

<sup>39</sup> ISA 330, paragraph 7(b)

<sup>40</sup> ISA 260 (Revised), paragraph 15

- ISA 701 requires the auditor to take into account significant risks when determining those matters that required significant auditor attention, which are matters that may be key audit matters.<sup>41</sup>
- Review of audit documentation by the engagement partner on or before the date of the auditor's report which allows significant matters, including significant risks, to be resolved on a timely basis to the engagement partner's satisfaction.<sup>42</sup>
- ISA 600 requires more involvement by the group engagement partner if the significant risk relates to a component in a group audit and for the group engagement team to direct the work required at the component by the component auditor.<sup>43</sup>

#### Assessing the Magnitude and Likelihood of the Risks of Material Misstatement

A229. In determining where on the spectrum of inherent risk an identified risk of material misstatement is assessed, the auditor uses professional judgment to assess both the magnitude and the likelihood of material misstatement. For a risk to be assessed as higher on the spectrum of inherent risk, it does not mean that both the magnitude and likelihood need to be assessed as high. Rather, it is the intersection of the magnitude and likelihood of the material misstatement on the spectrum of inherent risk that will determine whether the assessed inherent risk is higher or lower on the spectrum of inherent risk.

A229a. In determining significant risks, the auditor may first identify those assessed risks of material misstatement that have been assessed higher on the spectrum of inherent risk to form the basis for considering which risks may be close to the upper end. Being close to the upper end of the spectrum of inherent risk will differ from entity to entity, and will not necessarily be the same for an entity period on period. It may depend on the nature and circumstances of the entity for which the risk is being assessed. The determination of which of the assessed risks of material misstatement are close to the upper end of the spectrum of inherent risk, and are therefore significant risks, is a matter of professional judgment, unless the risk is of a type specified to be treated as a significant risk in accordance with the requirements of another ISA. ISA 240 provides further requirements and guidance in relation to the identification and assessment of the risks of material misstatement due to fraud.<sup>44</sup>

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<sup>41</sup> ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, paragraph 9

<sup>42</sup> ISA 220, paragraphs 17 and A18

<sup>43</sup> ISA 600, paragraphs 30 and 31

<sup>44</sup> ISA 240, paragraphs 25–27

Example:

Cash at a supermarket retailer would ordinarily be determined to be a high likelihood of possible misstatement (due to the risk of cash being misappropriated), however the magnitude would typically be very low (due to the low levels of physical cash handled in the stores). The combination of these two factors on the spectrum of inherent risk would be unlikely to result in the existence of cash being assessed as a significant risk.

An entity is in negotiations to sale a failing business segment. The auditor considers the effect on goodwill impairment, and may determine there is a higher likelihood of possible misstatement and a higher magnitude due to the impact of the inherent risk factors of judgment, uncertainty, and susceptibility to management bias or misappropriation of assets. This may result in goodwill impairment being assessed as a significant risk.

A229b. The auditor also takes into the account the relative effects of the inherent risk factors when assessing inherent risk. The lower the effect of the inherent risk factors, the lower the assessed risk is likely to be. However, risks of material misstatement that may be assessed as having higher inherent risk and may therefore be assessed as significant risks, may arise from matters such as the following:

- Transactions for which there are multiple acceptable accounting treatments such that subjectivity is involved.
- Accounting estimates that have high estimation uncertainty or complex models.
- Complexity in data collection and processing to support account balances.
- Account balances or quantitative disclosures that involve complex calculations
- Accounting principles that may be subject to differing interpretation.
- Changes in the entity's business that involve changes in accounting, for example, mergers and acquisitions.

A230. [Moved]

A231. [Moved]

*Risks for Which Substantive Procedures Alone Cannot Provide Sufficient Appropriate Audit Evidence* (Ref: Para. 51)

Why Risks for Which Substantive Procedures Alone Cannot Provide Sufficient Appropriate Audit Evidence are Required to be Identified

A231a. Due to the nature of a risk of material misstatement, and the control activities that address that risk, in some circumstances, the only way to obtain sufficient appropriate audit evidence is to test the operating effectiveness of controls. Accordingly, there is a requirement for the auditor to identify any such risks because of the implications for the design and performance of further audit procedures to address risks of material misstatement at the assertion level.

A231b. Paragraph 39 also requires the identification of controls that address risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence to be relevant to the audit

because the auditor is required, in accordance with ISA 330,<sup>45</sup> to design and perform tests of such controls.

#### Controls that Address Risks for Which Substantive Procedures Alone Cannot Provide Sufficient Appropriate Audit Evidence

A231c. Risks of material misstatement may relate directly to the recording of routine classes of transactions or account balances, and the preparation of reliable financial statements. Such risks may include risks of inaccurate or incomplete processing for routine and significant classes of transactions such as an entity's revenue, purchases, and cash receipts or cash payments.

A231d. Where routine business transactions are subject to highly automated processing with little or no manual intervention, it may not be possible to perform only substantive procedures in relation to the risk. This to be the case in circumstances where a significant amount of an entity's information is initiated, recorded, processed, or reported only in electronic form such as in an information system that involves a high-degree of integration across its IT applications. In such cases:

- Audit evidence may be available only in electronic form, and its sufficiency and appropriateness usually depend on the effectiveness of controls over its accuracy and completeness.
- The potential for improper initiation or alteration of information to occur and not be detected may be greater if appropriate controls are not operating effectively.

#### Example:

It is typically not possible to obtain sufficient appropriate audit evidence relating to revenue for a telecommunications entity based on substantive procedures alone. This is because the evidence of call or data activity does not exist in a form that is observable. Instead, substantial controls testing is typically performed to determine that the origination and completion of calls, and data activity is correctly captured (e.g., minutes of a call or volume of a download) and recorded correctly in the entity's billing system.

A231e. ISA 540 (Revised) provides further guidance related to accounting estimates about risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence.<sup>46</sup> In relation to accounting estimates this may not be limited to automated processing, but may also be applicable to complex models.

A231f. [*Moved*]

#### *Assessing Control Risk* (Ref: Para. 50)

A232. The auditor's intention to test the operating effectiveness of controls is based on the expectation that controls are operating effectively, and this will form the basis of the auditor's assessment of control risk. The initial expectation is based on the auditor's evaluation of the design and the determination of implementation of the identified controls in the control activities component. Once the auditor has tested the operating effectiveness of the controls in accordance with ISA 330, the auditor will be able to confirm the initial expectation about the operating effectiveness of controls. If the controls are not

<sup>45</sup> ISA 330, paragraph 8

<sup>46</sup> ISA 540 (Revised), paragraphs A87–A89

operating effectively as expected, then the auditor will need to revise the control risk assessment in accordance with paragraph 53. If the auditor does not intend to test the operating effectiveness of controls, the assessment of the risks of material misstatement is based on the auditor's assessment of inherent risk. A233. The auditor's assessment of control risk may be performed in different ways depending on preferred audit techniques or methodologies, and may be expressed in different ways.

A234. If the auditor intends to test the operating effectiveness of controls, the auditor takes into account whether one or a combination of controls will address the assessed inherent risk for the risk of material misstatement. The auditor may expect to test both direct and indirect controls, including general IT controls, and, if so, takes into account the combined expected effect of the controls when assessing control risk. If the control to be tested does not fully address the assessed inherent risk of the risk of material misstatement, the auditor determines the implications on the design of further audit procedures to reduce audit risk to an acceptably low level.

A235. The assessment of control risk takes into account the expected results from the auditor's planned tests of the operating effectiveness of controls relevant to the audit, including general IT controls. For controls in the control activities component, and for which the auditor intends to test the operating effectiveness, the auditor may identify related general IT controls.

A235a. When the auditor plans to test the operating effectiveness of an automated control, the auditor may also plan to test the operating effectiveness of the relevant general IT controls that support the continued functioning of that automated control to address the risks arising from the use of IT, and to provide a basis for the auditor's expectation that the automated control operated effectively throughout the period. When the auditor expects related general IT controls to be ineffective, this determination may affect the auditor's assessment of control risk at the assertion level depending on whether the auditor is able to perform other tests to address those risks arising from the use of IT. Further guidance about the procedures that the auditor may perform in these circumstances is provided in ISA 330.<sup>47</sup>

*[Para's A236 – A239 moved to new section for 'Risks for Which Substantive Procedures Alone Cannot Provide Sufficient Appropriate Audit Evidence' (see para's A231a – f)]*

#### *Evaluating Audit Evidence Obtained from Risk Assessment Procedures*

A239a. Audit evidence from risk assessment procedures comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions.<sup>48</sup> Obtaining audit evidence from risk assessment procedures in an unbiased manner may involve obtaining evidence from multiple sources within and outside the entity. However, the auditor is not required to perform an exhaustive search to identify all possible sources of audit evidence.

A239b. ISA 330 requires the auditor to obtain more persuasive audit evidence the higher the auditor's assessment of the risk.<sup>49</sup> Therefore, the consideration of the nature or quantity of the audit evidence from risk assessment procedures may be more important when inherent risks is assessed at the higher end of the spectrum of inherent risk.

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<sup>47</sup> ISA 330, paragraphs A29–A31

<sup>48</sup> ISA 500, paragraph A1

<sup>49</sup> ISA 330, paragraphs 7(b) and A19

*Classes of Transactions, Account Balances and Disclosures that are Not Significant, but are Material* (Ref: Para. 52)

A240. As explained in ISA 320,<sup>50</sup> materiality and audit risk are considered when identifying and assessing the risks of material misstatement in classes of transactions, account balances and disclosures. The auditor's determination of materiality is a matter of professional judgment, and is affected by the auditor's perception of the financial reporting needs of users of the financial statements.<sup>51</sup> For the purpose of this ISA and paragraph 18 of ISA 330, classes of transactions, account balances or disclosures are material if omitting, misstating or obscuring information about them could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements as a whole.

A241. There may be classes of transactions, account balances or disclosures that are material but have not been determined to be significant classes of transactions, account balances or disclosures (i.e., there are no relevant assertions identified).

Example:

The entity may have a disclosure about executive compensation for which the auditor has not identified a risk of material misstatement. However, the auditor may determine that this disclosure is material based on the considerations in paragraph A240.

A242. Audit procedures to address classes of transactions, account balances or disclosures that are material but are not determined to be significant are addressed in ISA 330.<sup>52</sup> When a class of transactions, account balance or disclosure is determined to be significant as required by paragraph 46, the class of transactions, account balance or disclosure, is also treated as a material class of transactions, account balance or disclosure for the purposes of paragraph 18 of ISA 330.

*Revision of Risk Assessment* (Ref: Para. 53)

A243. During the audit, information may come to the auditor's attention that differs significantly from the information on which the risk assessment was based.

Example:

The entity's risk assessment may be based on an expectation that certain controls are operating effectively. In performing tests of those controls, the auditor may obtain audit evidence that they were not operating effectively at relevant times during the audit. Similarly, in performing substantive procedures the auditor may detect misstatements in amounts or frequency greater than is consistent with the auditor's risk assessments. In such circumstances, the risk assessment may not appropriately reflect the true circumstances of the entity and the further planned audit procedures may not be effective in detecting material misstatements. Paragraphs 16 and 17 of ISA 330 provide further guidance about evaluating the operating effectiveness of controls.

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<sup>50</sup> ISA 320, paragraph A1

<sup>51</sup> ISA 320, paragraph 4

<sup>52</sup> ISA 330, paragraph 18



**Documentation** (Ref: Para. 54)

Scalability

A244. The manner in which the requirements of paragraph 54 are documented is for the auditor to determine using professional judgment.

**Example:**

In audits of less complex entities the documentation may be incorporated in the auditor's documentation of the overall strategy and audit plan.<sup>53</sup> Similarly, for example, the results of the risk assessment may be documented separately, or may be documented as part of the auditor's documentation of further procedures.<sup>54</sup>

A245. More detailed documentation may be required to support significant judgments where the auditor applies a higher level of professional judgment, for example when exercising professional judgment to support the rationale for difficult judgments made, that is sufficient to enable an experienced auditor, having no previous experience with the audit, to understand the nature, timing and extent of the audit procedures performed.

A246. For the audits of less complex entities, the form and extent of documentation may be simple in form and relatively brief. The form and extent of the auditor's documentation is influenced by the nature, size and complexity of the entity and its system of internal control, availability of information from the entity and the audit methodology and technology used in the course of the audit. It is not necessary to document the entirety of the auditor's understanding of the entity and matters related to it. Key elements<sup>55</sup> of understanding documented by the auditor may include those on which the auditor based the assessment of the risks of material misstatement. However, the auditor is not required to document every inherent risk factor that was taken into account in identifying and assessing the risks of material misstatement at the assertion level.

A247. For recurring audits, certain documentation may be carried forward, updated as necessary to reflect changes in the entity's business or processes.

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<sup>53</sup> ISA 300, *Planning an Audit of Financial Statements*, paragraphs 7 and 9

<sup>54</sup> ISA 330, paragraph 28

<sup>55</sup> ISA 230, paragraph 8



# AUASB Board Meeting Summary Paper

**AGENDA ITEM NO.**        **2.2**  
**Meeting Date:**            12 June 2019  
**Subject:**                    ISA 600 – Group Audits  
**Date Prepared:**            5 June 2019

**Action Required**

**For Information Purposes Only**

IAASB Project Objective	AUASB SMEs
<ol style="list-style-type: none"><li>Propose revisions to ISA 600 to strengthen the auditor’s approach to planning and performance of a group audit and clarify the interaction of ISA 600 to the other ISAs.</li><li>Propose consequential amendments to other standards that may be necessary as a result of revisions to ISA 600.</li><li>Determine whether non-authoritative guidance and support tools should be developed by the IAASB or others to supplement the revisions.</li></ol>	Rene
<b>AUASB Key Points</b>	
<p><b>A.     <u>Background and what is required from the AUASB</u></b></p> <p><b>1.     <i>What is the ATG seeking from the AUASB at the June 2019 AUASB meeting?</i></b></p> <p>The purpose of this summary paper is to:</p> <ol style="list-style-type: none"><li>Update the AUASB as to the status of the ISA 600 project with reference to the AUASB Submission on the IAASB's <i>Invitation to Comment Enhancing Audit Quality in the Public Interest: A Focus on Professional Scepticism, Quality Control and Group Audits</i> (Invitation to Comment); and</li><li>Seek AUASB input on the questions in the body of this Board Meeting Summary Paper at sections B2(c), B3(c) and B4(c).</li></ol> <p><b>2.     <i>Background:</i></b></p> <ol style="list-style-type: none"><li>In December 2016 and following on from the IAASB’s Invitation to Comment, the IAASB approved a project proposal to revise ISA 600. The project scoping included:<ul style="list-style-type: none"><li>scoping of group audits</li><li>stronger links to other ISAs particularly ISA 315 and ISA 220</li><li>communications between the global engagement team (GET) and component auditors</li><li>component auditors (CAs)</li></ul></li></ol>	

*This document contains preliminary views and/or AUASB Technical Group recommendations to be considered at a meeting of the AUASB, and does not necessarily reflect the final decisions of the AUASB. No responsibility is taken for the results of actions or omissions to act on the basis of reliance on any information contained in this document (including any attachments), or for any errors or omissions in it.*

- work effort on components identified in scope and non-significant components
- GETs work effort in relation to the consolidation process
- GETs evaluation of sufficiency and appropriateness of audit evidence
- component materiality and aggregation risk

- b) This project has been delayed/held back in order to progress the foundational standards which underpin ISA 600 (ISQM 1, ISA 220, ISA 315).
- c) This project is now back on the IAASB agenda to progress.
- d) The IAASB June 2019 meeting papers in relation to Group Audits, can be found [\[here\]](#).

**B. Key Points raised by the AUASB in the Invitation to Comment – mapped to IAASB plans to address**

*1 Broadening of ISA 600:*

- a) AUASB comments to the IAASB’s Invitation to Comment:
- (i) With the ever changing and more complex business landscapes and the way organisations are structured and operated, the AUASB considered that ISA 600 requires broadening so as to include all scenarios where one auditor uses the work of another auditor and not only in a group audit scenario. ISA 600 needs to cover not only group audits, but all environments where financial information is fed into a group financial report for example shared-service centres and joint ventures.
- (ii) One consideration when broadening the ISA could be a change in the name of ISA 600 to something more expansive, for example *Special Considerations – Using the Work of Other Auditors*. A name change could facilitate ISA 600 being applied to any scenario where one auditor involves the work of another auditor in the audit of financial reports with one such example being for group audit engagements. The definitions of “component” and “group” in ISA 600 may require revision or additional application material and examples to assist with the practical challenges of the aforementioned scenarios.
- b) IAASB Update:
- (i) The Task Force concluded that ISA 600 applies when the auditor is engaged to perform an **audit of group financial statements, including where component auditors are involved**, accordingly the Task Force is contemplating the following changes:
- Definition changes to component, group financial statements, consolidation process; group engagement team;
  - Term ‘component auditors’ replaced by ‘other auditors’;
  - Non-Controlled Entities: description of consolidation process would remove reference to cost method of accounting thereby excluding investments accounted for under the cost method from ISA 600. Investments accounted for by the equity method would still be captured by ISA 600, with the Task Force acknowledging practical challenges with reference to access.
- (ii) The Task Force intends to clarify scenarios such as shared service centres, and explain that if a risk of material misstatement is identified and assessed in a significant account or class of transactions that is processed by a shared service centre (e.g., revenue) or initiated by the shared service centre, the group engagement team needs to determine the appropriate response to the assessed risk and determine who will perform the work.
- c) Feedback Request from AUASB: None at this stage

*2 Top/Down approach:*

- a) AUASB comments to the IAASB’s Invitation to Comment

- (i) The AUASB considered that scoping of a component needs to use a combination of a top-down and bottom-up approach. A bottom-up approach to scoping may not appropriately focus the work of a component auditor on those aspects that are likely to be most significant in relation to the group financial statements. A top-down approach may result in the possibility that a misstatement at the component level is not detected which may lead to the group financial statements being materially misstated. Accordingly, the AUASB considered a combination of the two approaches to be preferable, that is, range/continuum, where some clients may be on one end, some on the other end and some in the middle where both are needed.
- (ii) The AUASB considered that it would be helpful to emphasise that significant risks identified by component auditors should also be considered by the GET to determine whether these risks may apply more broadly as the group auditor is not necessarily the best placed to determine and understand the significant risks at a component level. Furthermore, further clarification would be helpful about how significant risks identified at a group level might impact on a component and how this is communicated to the component auditor.

b) *IAASB Update:*

- (i) The Task Force acknowledges that a top-down approach may imply that the identification, assessment and response to the risks of material misstatement of the group financial statements is done by the GET without input, when and to the extent necessary, from component auditors with respect to certain components.
- (ii) A risk-based approach to planning and performing a group audit is more appropriate as it better focusses the GET on identifying the significant accounts, classes of transactions or disclosures in the group financial statements, and the related risks of material misstatement and links in with ISA 315.
- (iii) Under the risk-based approach, the GET is responsible for the identification, assessment and responses to the risks of material misstatement with involvement from component auditors to assist with the risk assessment. The GET then considers the most effective and efficient response to assessed risks (nature, timing, extent).
- (iv) The Risk based approach is *similar to extant* ISA 600 in the following:
  - objective of a group audit remains the same
  - understanding the entity and its environment remains fundamental
  - Two-way communication between component auditor and GET remains critical
- (v) The Risk based approach is *different to extant* ISA 600 in the following:
  - Closer alignment to ISA 315 –scope of work responsive to risk (extant – scope of work driven by identification of components)
  - Given the focus on risk there may be no need to retain identification of significant components; however components that are financially significant may still need to be considered.

c) Feedback Request from AUASB: Views on risk-based approach and significant components

3 *Access Matters*

- a) AUASB comments to the IAASB’s Invitation to Comment
  - (i) Associates, non-controlled entities and joint ventures which may be significant components but are not controlled by group management, continue to cause access issues in the Australian environment. The situation is compounded in jurisdictions that do not have

similar legal and regulatory requirements to those in the jurisdiction where the group engagement team is located.

- b) IAASB Update:
  - (i) The Task Force will link ISA 600 more heavily into the new requirements under the revised ISA 220 which would include a consideration about whether the GET will have access to the information necessary to perform the engagement, or to the individuals who provide such information. The Task Force discussed a different structure that would place all relevant requirements relating to engagement acceptance and continuance under an umbrella requirement that links to key requirements in ISA 220. The special consideration for group audits mainly relates to access to information and that this could be referenced to the requirements in ISA 220 (Revised) related to acceptance and continuance of client relationships and audit engagements. The Task Force has only commenced preliminary considerations in this area, refer [here](#) for IAASB indicative drafting in relation to ISA 220 considerations.
- c) Feedback request from AUASB: Does the AUASB consider that the revised ISA 220 and appropriate linkage from ISA 600 to ISA 220 will assist with access issues? How else could the IAASB address these issues?

#### 4 *Ability to Direct and Supervise*

- a) AUASB comments to the IAASB's Invitation to Comment
  - (i) The ability for a group auditor to direct and supervise the work of a component auditor in some situations continues to cause practical challenges in the Australian environment. An example of this scenario is where the component entity is listed in its own right and the component entity's financial report may not be prepared for the primary purpose of inclusion within the group financial report.
- b) IAASB Update:
  - (i) The Task Force intend to demonstrate how the requirements in the revised ISA 220 would be applied to manage and achieve audit quality in a group audit and consider the revisions needed to sufficiently direct, supervise and review the work of the engagement team.
  - (ii) The Task Force discussed the GET's use of audit evidence from audits of components required by statute, regulation or for another reason. The Task Force considers that, in these situations, the involvement of the GET should be similar to any other situation in which work is performed on a component by a component auditor, and such work is used by the GET to support the audit of the group financial statements and plans to include guidance in that regard in the revised standard.
- c) Feedback request from AUASB: Does the AUASB consider that the revised ISA 220 and appropriate linkage from ISA 600 to ISA 220 will assist with this matter? How else could the IAASB address these issues?

#### 5 *Component Auditors*

- a) AUASB comments to the IAASB's Invitation to Comment
  - (i) The AUASB supports ISA 600 clarifying the role of component auditors by expanding requirements and application material within ISA 600 directed at component auditors.

- (ii) There is a need for greater clarity and guidance in scenarios whereby the component entity is a listed entity where there are continuous disclosure requirements.
  - (iii) Greater clarity could be provided to the GET in determining the nature, timing and extent of their involvement in the work of the component auditors including explaining interactions and providing examples to illustrate the wide variety of circumstances impacting the determination of the nature, timing and extent of the GET's involvement in the work of the component auditor.
- b) IAASB Update:
- (i) ISA 600 revision will be linked into the strengthened requirements in ISA 220 (Revised) relating to the responsibility of the group engagement partner to manage quality at the engagement level. This would include the direction, supervision and review of the work of, and communications with, component auditors
  - (ii) The Task Force will enhance stand back requirements with reference to sufficient appropriate audit evidence, sufficiency of involvement of group engagement partner.
  - (iii) Task Force is still to consider communication and involvement of GET with/in the work of component auditors.
- c) Feedback request from AUASB: No specific input at this stage.

6 *Materiality*

- (a) AUASB comments to the IAASB's Invitation to Comment
- (i) Additional guidance is required for matters that are specifically relevant to component materiality, component performance materiality and component trivial thresholds, particularly in relation to the concept of aggregation risk.
  - (ii) Where there are a large number of non-significant components, application material to address the group engagement team's considerations about the work to be performed on the non-significant components as well as guidance on how the GET should determine which non-significant components require procedures as well as how to determine when a sufficient number of components have been selected for testing.
  - (iii) Clarifying the expected work effort related to analytical procedures at the group level for non-significant components and application material clarifying what may influence or constitute sufficient "coverage".
- (b) IAASB Update:
- (i) Materiality including performance materiality at the component level will be revisited in light of the new risk-approach and potentially no longer having the concepts significant components, but perhaps a financially significant component.
- (c) Feedback request from AUASB: No specific input at this stage.

7 *Documentation*

- (a) AUASB comments to the IAASB's Invitation to Comment
- (i) Application material could be strengthened in relation to documentation requirements regarding the group engagement team's evaluation of the component auditor's communication, including the nature of any review of documentation.
- (b) IAASB Update:

(i) To be considered in due course by the IAASB.
(c) Feedback request from AUASB: No specific input at this stage.
<b>IAASB Timeline</b>
<ol style="list-style-type: none"> <li>1. Full draft standard for IAASB review – December 2019 IAASB meeting.</li> <li>2. Approval of ED – March 2020 IAASB meeting.</li> </ol>
<b>AUASB influencing activities</b>
ATG to prepare briefing notes for distribution to Australasian IAASB members including the AUASB Chair.
<b>Next steps / milestones for this project</b>
Refer timeline above.



# AUASB Board Meeting Summary Paper

**AGENDA ITEM NO.**        **2.3.0**  
**Meeting Date:**            12-13 June 2019  
**Subject:**                    Audit Evidence  
**Date Prepared:**            4 June 2019  
**Prepared By:**              Tim Austin

**Action Required**

**For Information Purposes Only**

IAASB Project Objective	AUASB Subject Matter Experts
1. The objective of this project is to inform the newly formed Audit Evidence Working Group (AEWG) through exploring issues related to audit evidence and identifying the key issues to be addressed by the AEWG. This project is in the information gathering stage and <b>may</b> result in standard-setting activities.	Tim/TBD
<b>AUASB Key Points</b>	
<b>Background</b>	
2. At the March 2019 IAASB Meeting, the Audit Evidence Working Group (AEWG) presented to the IAASB an update on the AICPA’s audit evidence project including a walkthrough of the proposed requirements and the key issues identified during the project. The paper prepared by the AEWG outlined the issues the AEWG will consider as part of their project.  3. The issues presented were discussed by the IAASB in a breakout session where feedback from IAASB Members included that the AEWG need to: <ul style="list-style-type: none"> <li>(a) further understand the issues raised and the activities needs to be exploratory at this stage;</li> <li>(b) prioritise the issues and consider the most appropriate response to priority issues;</li> <li>(c) keep a broader perspective and understand that issues do not just impact ISA 500.</li> </ul>	
<b>June 2019 IAASB Paper</b>	
4. The June 2019 IAASB Audit Evidence paper, based on the feedback from the March 2019 IAASB Meeting, provides an itemisation of issues related to ISA 500 and other standards and possible responses to each (Appendix 2 and Appendix 3 of the IAASB Paper).  5. The AEWG are of the view that the information and evidence gathering activities already undertaken by the IAASB are sufficient to inform the project and are asking for the IAASB to finalise the list of issues to be considered by the AEWG. Feedback from this meeting will be used to develop the scope of the audit evidence project.  6. The AUASB Technical Group has provided Appendix 2 and Appendix 3 of the IAASB Paper as	

*This document contains preliminary views and/or AUASB Technical Group recommendations to be considered at a meeting of the AUASB, and does not necessarily reflect the final decisions of the AUASB. No responsibility is taken for the results of actions or omissions to act on the basis of reliance on any information contained in this document (including any attachments), or for any errors or omissions in it.*



**Agenda Item 2.3.1** for the AUASB to review. The ATG requests AUASB Members to review the issues in the context of **Questions 1-3** below.

7. The ATG over the last 12 months has collected feedback from Australian stakeholders regarding their challenges with the ISAs and technology. The ATG, to support the AUASB Chair's role as an IAASB Member, will prepare a complete list of all the technology challenges raised by Australian stakeholders which can be linked to audit evidence. As the ATG feedback collection has largely focussed on technology, there may be audit evidence issues that AUASB Members are aware of which are not technology specific which should be raised with the AEWG.
8. In addition to a review of the challenges, the ATG will also consider whether the AEWG recommended responses to each challenge are appropriate for the Australian environment.

**IAASB timeline and impact on AUASB activities/Next steps**

9. At this stage of the project the AEWG is recommending to the IAASB that the focus of the standard-setting efforts should focus on ISA 500 and necessary conforming amendments. The AEWG has prepared the below proposed timeline for amendments to ISA 500.

September 2019	Approval of project proposal
March 2020	Exploration of issues
June 2020	Exploration of issues and working draft
September 2020	First read of proposed ISA 500 (revised)
December 2020	Second read of proposed ISA 500 (revised)
March 2021	Approval of ED of ISA 500 (revised)

**Questions**

1. Do AUASB Members have any issues related to audit evidence which have not been identified in **Agenda Item 2.3.1**?
2. Are AUASB Members supportive of the approach to initially focus on ISA 500 and necessary conforming amendments (refer to paragraph 9)?
3. Does the AUASB have any other feedback which should be taken into account by the AEWG when developing the Project Plan?

**Material Presented**

- |                    |                                       |
|--------------------|---------------------------------------|
| Agenda Paper 2.3.0 | BMSP – IAASB Audit Evidence           |
| Agenda Paper 2.3.1 | IAASB Audit Evidence Appendix Extract |

**Action Required**

No.	Action Item	Responsibility	Due Date
1.	AUASB Members to review the appendix extract provided to assess the completeness of the issues.	AUASB	12 June 2019

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## Appendix 2

### Itemization of Issues and Possible Actions

Appendix 2 has been organized into each ISA and identifies the issues related to audit evidence and technology and the actions that are available to address each of the issues. This Appendix first shows the issues related to ISA 500, and then the issues related to the remaining ISAs in sequential order of those ISAs.

The actions that are available to address the issues related to audit evidence are as follows:

1. Non-authoritative guidance to be developed, which is subcategorized into:
  - 1.1 Guidance addressing the effect of technology when applying certain aspects of the ISAs.
  - 1.2 Guidance addressing audit-evidence-related issues when applying certain aspects of the ISAs.
2. Matters that are relevant to a current project.
3. A project to revise the standards to address audit evidence (ISA 500 and possibly related standards).
4. A targeted project to address relevant aspects of technology across the ISAs (i.e. possibly in the form of an omnibus standard focused on technology).
5. The issue is acknowledged and will be considered as part of the IAASB's forward work plan.
6. The matter is presently not considered an issue.

#	Description of Issue	AEWG Views	Recommended Action(s)
<b>ISA 500, Audit Evidence</b>			
1	Questions have arisen about the purpose of ISA 500 in the context of the other ISAs, in particular whether ISA 500 is intended to be a performance standard. <sup>13</sup>	The AEWG is of the view that ISA 500 is relevant to many ISAs and the relationship between ISA 500 and the other ISAs should be further considered, in particular whether ISA 500 is a performance standard, or a foundational standard that is applicable to the other ISAs. The AEWG recognizes that audit evidence is obtained and used by the auditor in each conclusion reached by the auditor in performing an audit.	3

<sup>13</sup> For example, the objective of ISA 500 indicates that "the objective of the auditor is to design and perform audit procedures", and paragraph 6 requires the auditor to "design and perform audit procedures."

#	Description of Issue	AEWG Views	Recommended Action(s)
2	Evolution in <b>technology</b> and the nature and number of sources of <b>information</b> has resulted in descriptions in ISA 500 becoming outdated, <sup>14</sup> and raised questions as to whether ISA 500 should be updated to reflect new technology and information sources.	The AEWG recognizes this as a modernization issue that requires updates to ISA 500.	3 4
<b>Audit procedures</b>			
3	New <b>technologies</b> have given rise to confusion about whether certain technological tools are audit procedures in their own right, or whether they provide information that the auditor performs audit procedures on (e.g., pictures from a drone) (i.e., a lack of clarity on the difference between “information (to be used as audit evidence)”, “evidence” in general as used in IAASB standards other than the ISAs, “audit evidence” and “audit procedures”).	The AEWG agrees that these are issues that should be clarified, however the definitions would need careful consideration, including in the context of the IAASB’s other standards. The AEWG acknowledges the need to explore a definition of audit procedures, including considering whether all procedures undertaken during an audit are an audit procedure and whether an audit procedure is a combination of multiple actions or procedures.	1.1 3
4	New <b>technologies</b> have raised questions about where audit procedures performed using new technologies fit within: <ul style="list-style-type: none"> <li>• The categories of audit procedures (i.e., inspection, observation, inquiry etc.); and</li> <li>• The nature of audit procedures (i.e., risk assessment, tests of controls, tests of details).</li> </ul>	The AEWG is of the view that guidance could be developed to clarify how the ISAs may be applied to the use of new tools and techniques. Such guidance could highlight that new tools and techniques may provide different types of results than manual-based procedures and the results may be used by the auditor in a different manner. For example, the use of new tools and techniques as risk assessment procedures may be more effective and cover a greater portion of the population, but the auditor may have many more items to investigate.	1.2 3

<sup>14</sup> For example, paragraph 5(a) of ISA 500 describes accounting records as the records of initial accounting entries and supporting records, such as checks and records of electronic fund transfers; invoices; contracts; the general and subsidiary ledgers, journal entries and other adjustments to the financial statements that are not reflected in journal entries; and records such as work sheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures.

#	Description of Issue	AEWG Views	Recommended Action(s)
		On the other hand, this may result in the need for less tests of details.	
5	The use of new <b>technology</b> to perform audit procedures has raised questions about whether an audit procedure can be both a risk assessment procedure and a substantive procedure at the same time, i.e., a procedure that serves a dual purpose. This is particularly the case for certain data analytic tools.	<p>The AEWG notes that this principle has been acknowledged in paragraph A15 of ED-315. In the context of ISA 500, further consideration could be given to:</p> <ul style="list-style-type: none"> <li>• Clarifying that an audit procedure can be both a risk assessment procedure and a substantive procedure, consistent with the approach in ED-315.</li> <li>• Emphasizing that the purpose of the procedure needs to be established when designing the audit procedure and other ISAs apply in circumstances when a procedure is both a risk assessment procedure (ISA 315 (Revised)) and a substantive procedure (e.g., ISA 330 and ISA 520).</li> </ul>	<p>1.1 1.2 2 (ISA 315 TF) 3</p>
6	The use of new <b>technology</b> to perform audit procedures has raised questions about the auditor's evaluation of whether the audit procedure is designed in a manner that provides the audit evidence needed about the relevant assertion being tested. For example, there may be overreliance on an audit procedure because of the use of technology in performing the procedure (i.e., a lack of due care or objectivity that impairs the exercise of professional skepticism).	<p>The AEWG agrees that despite the benefits, overreliance on technology is a concern and further actions could be taken to highlight the need for professional skepticism in applying the audit procedure.</p> <p>This issue has also been addressed in paragraph A56 of ED-220.</p>	<p>1.1 1.2 3</p>
<b>Sufficient appropriate audit evidence</b>			
7	Auditors are required to exercise professional judgment in concluding whether sufficient appropriate audit evidence has been obtained, and, if not, when to seek further evidence from additional sources. Given concerns about auditors appropriately exercising <b>professional</b>	The AEWG is of the view that more could be done to address what factors would prompt an auditor to seek further audit evidence from additional sources. The AEWG noted the work already undertaken by the PSWG,	<p>1.2 3</p>

#	Description of Issue	AEWG Views	Recommended Action(s)
	<b>skepticism</b> , questions have arisen about whether ISA 500 could more robustly address the need for professional skepticism when making such judgments.	which may provide an important reference point for these considerations.	
8	<p>The evolution in the number and nature of sources of <b>information</b> and use of <b>technology</b> to perform audit procedures have raised questions about the factors that are considered by the auditor in concluding whether sufficient appropriate audit evidence has been obtained. It brings into question:</p> <p>(a) Whether the definitions of appropriateness of audit evidence and sufficiency of audit evidence<sup>15</sup> are appropriate.</p> <p>(b) What factors are considered by the auditor in concluding whether sufficient appropriate audit evidence has been obtained.</p>	<p>The AEWG is of the view that the concepts of “appropriate audit evidence” and “sufficient audit evidence” are important concepts that are integral to the ISAs. The AEWG suggests that clarification of these concepts could facilitate an improved understanding of their intended meaning, and the work already undertaken by the PSWG may provide an important reference point for these considerations. The AEWG recognizes that the meaning of sufficient appropriate audit evidence is closely related to the concept of reasonable assurance and an acceptably low level of audit risk, and that fundamental issues of this nature are beyond the remit of the project.</p> <p>The AEWG also suggests clarifying that the factors considered by the auditor in determining whether sufficient appropriate audit evidence has been obtained are considered at various points throughout the audit, i.e., regarding:</p> <ul style="list-style-type: none"> <li>• Risks of material misstatement related to the account balance, class of transaction or disclosure; and</li> <li>• The overall opinion on the financial statements.</li> </ul>	3
<b>Information to be used as audit evidence</b>			
9	Auditors are required to exercise professional judgment in considering the reliability of	The AEWG is of the view that more could be done to address the factors	3

<sup>15</sup> Paragraph 5(e) of ISA 500 describes the sufficiency of audit evidence as the measure of the quantity of audit evidence.

#	Description of Issue	AEWG Views	Recommended Action(s)
	information to be used as audit evidence. Given concerns about auditors appropriately exercising <b>professional skepticism</b> , questions have arisen about whether ISA 500 could more robustly address the need for professional skepticism when making such judgments.	that may be considered by an auditor in considering the reliability of information to be used as audit evidence. The AEWG noted the work already undertaken by the PSWG, which may provide an important reference point for these considerations.	
10	The evolution in the nature and number of sources of <b>information</b> has brought into question the appropriateness of certain statements in the standards about information obtained internally and externally. <sup>16</sup> In some instances, there may be overreliance on certain information sources without appropriate <b>professional skepticism</b> being exercised.	The AEWG recognizes this as a modernization issue that requires updates to the standard.  The AEWG also recognizes that there are certain information sources or technologies where there is an increased risk of overreliance, such as blockchains. However, it is not appropriate to address specific types of technologies or information sources in the standards. Therefore, in addition to addressing the overreliance on information sources and technology in a principles-based way in the standards, further guidance may be appropriate to address specific types of technologies relevant to today's environment. The AEWG noted the work already undertaken by the PSWG, which may provide an important reference point for these considerations.	1.1 3
11	Questions have arisen regarding whether all <b>information</b> to be used as audit evidence should be subject to the same rigor when considering the relevance and reliability of such information. For example, should information to be used in risk assessment procedures be subject to the	The AEWG is of the view that there is a need to emphasize or clarify the matters considered by the auditor when considering the relevance and reliability of information, including:	1.2 2 3

<sup>16</sup> For example, paragraph A31 of ISA 500 includes statements that may no longer be appropriate in today's environment, including statements such as:

- The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.
- The reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, imposed by the entity are effective.

#	Description of Issue	AEWG Views	Recommended Action(s)
	<p>same level of consideration as information to be used in a substantive analytical procedure?</p>	<ul style="list-style-type: none"> <li>• Clarifying that the nature and purpose of the audit procedure affects the required relevance and reliability of the information.</li> <li>• Explaining the need for appropriate planning for gathering audit evidence, for example, planning which information sources will be used and the criteria for that information, the tools and techniques to be used and the engagement team members who will apply the tools and techniques, and considering the degree to which the information achieves the planned criteria.</li> </ul> <p>The AEWG recognizes that the relevance and reliability of information is also referenced in ED-315.</p> <p>The AEWG also notes that there are some inconsistencies across ISA 500 because in some places it refers to the relevance and reliability of audit evidence, rather than information to be used as audit evidence, for example, paragraphs 11, A5 and A31.</p>	
12	<p>The evolution in technology and the nature and number of sources of <b>information</b> has created challenges in considering the reliability of internal and external information. For example:</p> <ul style="list-style-type: none"> <li>• Considering the reliability of information from an external source is challenging in certain circumstances given access issues.</li> <li>• There may be confusion as to when the information source is a service organization, and therefore when ISA 402<sup>17</sup> applies. For example, in the case</li> </ul>	<p>The AEWG is of the view that there could be clarification of when an information source is a service organization, including more specific guidance that addresses certain types of information sources or technologies.</p> <p>With respect to the other two issues, the AEWG is of the view that guidance could explore these issues, for example:</p> <ul style="list-style-type: none"> <li>• The extent to which an auditor may use information generated by artificial intelligence (AI),</li> </ul>	<p>1.1 1.2 3</p>

<sup>17</sup> ISA 402, *Audit Considerations Relating to an Entity Using a Service Organization*

#	Description of Issue	AEWG Views	Recommended Action(s)
	<p>of information generated through a blockchain, questions have arisen about whether the blockchain could be considered a third party service organization and whether it forms part of the entity's information system relevant to financial reporting.</p> <ul style="list-style-type: none"> <li>Auditors lack appropriate expertise in the algorithms underlying new technology that is used to generate information.</li> </ul>	<p>particularly when it is based on unstructured machine learning.</p> <ul style="list-style-type: none"> <li>How the auditor may determine that the information generated by AI is appropriate (e.g., the entity would need to be able to explain to the auditor how the technology generated the information).</li> </ul>	
13	The evolution in the nature and number of sources of <b>information</b> has brought into question the differentiation in work effort regarding the reliability of information between information produced by the entity and other information sources. <sup>18</sup>	The AEWG recognizes this as a modernization issue that requires updates to ISA 500.	3
14	The evolution in the nature and number of sources of <b>information</b> has brought into question the auditor's responsibilities in circumstances when there is information that contradicts management's assertions but the reliability of that information may not be determinable, for example, because of its source (e.g., social media).	The AEWG is of the view that these situations relate to the auditor's professional skepticism and that further guidance that draws out the work of the PSWG and how it applies to these circumstances would be useful.	1.2 3
15	The factors considered in the evaluation of the reliability of <b>information</b> are different in ISA 500 compared to ISA 520, which creates confusion about the attributes of information that affect the reliability of information. <sup>19</sup>	The AEWG is of the view that the difference is due to the specific nature of analytical procedures dealt with in ISA 520. Therefore, the AEWG is of the view that the use of different factors is appropriate.	1.2 6

<sup>18</sup> Paragraph 7 of ISA 500 indicates that when designing and performing audit procedures, the auditor shall **consider the relevance and reliability** of the information to be used as audit evidence. However, paragraph 9 imposes additional responsibilities when using information produced by the entity; it requires the auditor **to evaluate whether the information is sufficiently reliable** for the auditor's purposes. It is also notable that paragraph 5(b) of ISA 520 requires the auditor to **evaluate the reliability of data** from which the auditor's expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparation.

<sup>19</sup> Paragraph 9 of ISA 500 requires the auditor to evaluate whether the information is sufficiently reliable for the auditor's purposes, including, as necessary in the circumstances (a) obtaining audit evidence about the accuracy and completeness of the information; and (b) evaluating whether the information is sufficiently precise and detailed for the auditor's purposes. Paragraph 5(b) of ISA 520 describes the evaluation of the reliability of data as taking account of source, comparability, and nature and relevance of information available, and controls over preparation.



#	Description of Issue	AEWG Views	Recommended Action(s)
16	The increasing use of <b>information</b> generated by the client's IT applications in performing audit procedures has raised questions about the extent of understanding and testing needed of general IT controls and application controls, and the impact of deficiencies in general IT controls and application controls on the reliability of that information.	<p>The AEWG notes that ED-315 addresses the extent to which the auditor needs to have an understanding of general IT controls and application controls.</p> <p>The AEWG notes that there may be a need to address IT with respect to testing controls, and the impact of deficiencies in these controls on the reliability of information.</p>	2 (ISA 315 TF) 5 (ISA 330)
17	The standards use the terms " <b>information</b> " and " <b>data</b> ", and this raises questions about whether they are different and should be subject to different considerations.	The AEWG is of the preliminary view that there is no need to distinguish between information and data for purposes of evaluating audit evidence, however the actions undertaken in relation to issue 3 could affect this view. The AEWG further notes that these terms are used intermittently throughout the ISAs.	6
<b>Use of a Management's Expert</b>			
18	The evolution in the nature and number of sources of <b>information</b> and introduction of new application material dealing with external information sources has raised questions about the distinction between a management's expert and an external information source.	<p>It is acknowledged that conforming amendments to ISA 500 were made as part of the project on ISA 540 (Revised)<sup>20</sup> and resulted in new material on external information sources. The AEWG is of the view that further clarification of the difference between a management's expert and external information source may be useful.</p> <p>The AEWG also notes that clarification of the difference between an auditor's expert, information source and when a technology specialist is a member of the engagement team would also be useful. The AEWG notes that the definition of "engagement team" has been addressed in ED-220. The AEWG plans to ensure that</p>	1.2 2 (ISA 220 TF) 3

<sup>20</sup> ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

#	Description of Issue	AEWG Views	Recommended Action(s)
		appropriate coordination is undertaken with the ISA 220 Task Force.	
<b>Selecting items for testing</b>			
19	The use of new <b>technologies</b> brings into question whether the requirements and application material dealing with the selection of items for testing are relevant and appropriate for certain types of audit procedures.	<p>The AEWG is of the view that paragraph 10 of ISA 500 is appropriate. However, the AEWG suggests clarifying in ISA 500 when ISA 530<sup>21</sup> is applicable.</p> <p>The AEWG also notes that there are concerns about the application of sampling techniques, and how this affects the consideration of sufficient appropriate audit evidence, and that possible revisions may also be needed to ISA 530.</p>	1.2 3 5 (ISA 530)
<b>Inconsistency in audit evidence</b>			
20	Continued audit failures highlight concerns about the extent of <b>professional skepticism</b> exercised by auditors. This includes concerns about the auditor's professional skepticism and bias towards seeking evidence to support management's assertions (consistent or corroborating evidence) rather than evidence that is inconsistent with management's assertions.	<p>The AEWG is of the view that there could be clarification about how contradictory evidence is related to inconsistent evidence.</p> <p>The AEWG further notes that auditor bias is related to the need to apply objectivity, which is a principle of relevant ethical requirements. The AEWG is of the view that the application of the fundamental principles of the IESBA Code<sup>22</sup> in the context of the audit could be explained in ISA 500 (the AEWG notes that the ISAs refer to relevant ethical requirements but do not explain how the principles apply to the performance of the audit).</p>	1.2 3

<sup>21</sup> ISA 530, *Audit Sampling*

<sup>22</sup> *International Ethics Standards Board for Accountants' International Code of Ethics for Professional Accountants (Including International Independence Standards)*

#	Description of Issue	AEWG Views	Recommended Action(s)
<b>ISSUES IN OTHER ISAs RELATED TO AUDIT EVIDENCE AND TECHNOLOGY</b>			
<b>ISA 200, OVERALL OBJECTIVES OF THE INDEPENDENT AUDITOR AND THE CONDUCT OF AN AUDIT IN ACCORDANCE WITH INTERNATIONAL STANDARDS ON AUDITING</b>			
21	Evolution in <b>technology</b> and the nature and number of sources of <b>information</b> raises questions about whether ISA 200 should be updated to reflect new technology and information sources. For example, the application material related to control risk, inherent risk and detection risk could discuss factors arising from technology that affect these risks.	The AEWG recognizes this as a modernization issue that requires updates to the standard. As the issue relates to technology, it could be updated as part of a targeted project to address technology across the ISAs.	4
<b>ISA 210, AGREEING THE TERMS OF AUDIT ENGAGEMENTS</b>			
22	Evolution in <b>technology</b> and the nature and number of sources of <b>information</b> raises questions about whether ISA 210 should be updated to reflect new technology and information sources. For example, the application material discussing the content of the engagement letter could include technology-related issues, such as the availability of algorithms and audit trails, access to key sources of internal and external data, security over data and arrangements with service providers (e.g., data warehouses).	The AEWG recognizes this as a modernization issue that requires updates to the standard. As the issue relates to technology, it could be updated as part of a targeted project to address technology across the ISAs.	4
<b>ISA 230, AUDIT DOCUMENTATION</b>			
23	Evolution in <b>technology</b> raises questions about whether ISA 230 should be updated to reflect new technology. For example: <ul style="list-style-type: none"> <li>• The definition of audit file may be outdated.</li> <li>• Descriptions about the form, content and extent of audit documentation could include examples more reflective of technological tools.</li> </ul>	The AEWG recognizes this as a modernization issue that requires updates to the standard. As the issue relates to technology, it could be updated as part of a targeted project to address technology across the ISAs.	4
24	The emergence of <b>new technologies</b> has given rise to questions about the auditor's documentation, including:	The AEWG is of the view that the principles dealing with documentation remain appropriate and given the principles-based nature of ISA 230, it	1.1 4

#	Description of Issue	AEWG Views	Recommended Action(s)
	<ul style="list-style-type: none"> <li>• How the auditor is expected to document the procedures performed in order that the documentation test is met (i.e., an experienced auditor having no connection with the audit is able to understand how the technology operated). This includes, for example:               <ul style="list-style-type: none"> <li>○ How to document iterations of an analytical tool, e.g., when the test is refined.</li> <li>○ How to document in circumstances when machine learning is used by an entity and/or the auditor.</li> <li>○ How to document the algorithms supporting the technology (e.g., AI's "black box").</li> <li>○ Documentation expectations related to testing the information or underlying data.</li> </ul> </li> <li>• Documentation challenges arising from the client's use of technology, for example, in circumstances when the client's information may only be available for a short period of time (e.g., in the case of many AI related applications).</li> </ul>	<p>is adaptable for circumstances when technology is used by the entity, or when technology is used by the auditor in performing the procedure. However, the AEWG suggests further exploring the need to focus on the degree to which documentation supports an understanding of the conclusions reached (i.e., instead of documentation that supports an ability to understand the audit procedures performed). In this regard, the AEWG drew similarities to the use of the work of an auditor's expert, i.e., that the auditor does not reperform the expert's work, but instead understands how the work is suitable for the purposes of the audit.</p> <p>The AEWG recognizes that some of the documentation challenges are also specific to certain types of technology, such as AI, and therefore guidance may provide clarity about how ISA 230 can be applied to such technology.</p>	
<b>ISA 240, THE AUDITOR'S RESPONSIBILITIES RELATING TO FRAUD IN AN AUDIT OF FINANCIAL STATEMENTS</b>			
25	<p>Evolution in <b>technology</b> and the nature and number of sources of <b>information</b> raises questions about whether ISA 240 should be updated to reflect new technology and information sources. For example:</p> <ul style="list-style-type: none"> <li>• The manner in which fraud takes place, as described in paragraphs A3–A5 could include fraud arising from the entity's use of technology.</li> <li>• The audit procedures responsive to fraud, as described in paragraph A37</li> </ul>	<p>The AEWG agrees that there may be circumstances when the use of technology may be more effective than manual procedures in identifying fraud and addressing the risks of material misstatement due to fraud. However, as the standards should not imply that technology is required, the AEWG suggests further guidance addressing the impact of technology on fraud. ED-220 has also addressed the need for appropriate resources to perform the</p>	1.1 4

#	Description of Issue	AEWG Views	Recommended Action(s)
	<p>could include examples of audit procedures that are performed using technology.</p> <ul style="list-style-type: none"> <li>The examples of fraud risk factors in Appendix 1 of the standard could include fraud risk factors arising from the entity's use of technology or new information sources (e.g., complexity of the algorithms, a lack of management's understanding of technology used across the entity, unreliable source data).</li> <li>The examples of audit procedures to address the risks of material misstatement due to fraud in Appendix 2 of the standard could include audit procedures that are performed using technology.</li> </ul>	<p>engagement, including technological resources. The AEWG also recognizes that the standard could be modernized to include examples for technology.</p>	
<b>ISA 265, COMMUNICATING DEFICIENCIES IN INTERNAL CONTROL TO THOSE CHARGED WITH GOVERNANCE AND MANAGEMENT</b>			
26	<p>Evolution in <b>technology</b> raises questions about whether ISA 265 should be updated to reflect new technology. For example, the application material addressing examples of significant deficiencies and indicators of significant deficiencies could include examples related to the entity's use of technology.</p>	<p>The AEWG recognizes that the standard could be modernized to include examples for technology.</p>	4
<b>ISA 300, PLANNING AN AUDIT OF FINANCIAL STATEMENTS</b>			
27	<p>Evolution in <b>technology</b> raises questions about whether ISA 300 should be updated to reflect new technology. For example:</p> <ul style="list-style-type: none"> <li>The standard could address the timing of planning given the effect of technology, including the need to plan the engagement early in circumstances when the entity's use of technology is pervasive and information may only be available for short time periods.</li> <li>The standard could address the need for planning in circumstances when the</li> </ul>	<p>The AEWG agrees that guidance that highlights some of the planning considerations when using technology to perform the audit procedures, or when the client is using technology, would be useful.</p> <p>The AEWG recognizes that the standard could be modernized to include examples for technology.</p>	1.1 4

#	Description of Issue	AEWG Views	Recommended Action(s)
	<p>auditor may embed the auditors' technology in the client's systems in order to extract data for audit purposes.</p> <ul style="list-style-type: none"> <li>Paragraph A8 and the appendix could be expanded to discuss the need for technological and intellectual resources on the engagement, including the need for human resources with technological expertise</li> </ul>		
<b>ISA 320, MATERIALITY IN PLANNING AND PERFORMING AN AUDIT</b>			
28	<p>Evolution in <b>technology</b> used to perform audit procedures has raised questions about the concept of performance materiality in circumstances when 100% of the population is tested, or a significant portion.</p>	<p>The AEWG is of the view that 100% testing is a perception because it is not possible to obtain complete evidence regarding all assertions or risks for an account balance, class of transaction or disclosure. The AEWG also noted that there is a difference between substantive testing of every item of a population from analyzing 100% of a population in order to identify items for further substantive testing. Furthermore, performance materiality is about aggregation risk – that is, the need to aggregate residual audit risk for assertions for items in the financial statements when considering overall audit risk for the financial statements as a whole. Since there is always some remaining audit risk (there is no such thing as absolute assurance), performance materiality is always relevant, even if it may be to a lesser degree in some circumstances.</p>	1.1 6
<b>ISA 330, THE AUDITOR'S RESPONSES TO ASSESSED RISKS</b>			
29	<p>Evolution in <b>technology</b> has increased the risk of auditors over-relying on controls over the preparation of information and heightened the need for the standard to emphasize considerations about the relevance and</p>	<p>The AEWG is of the view that overreliance on controls over the preparation of information is not a new issue. As the issue is <i>not</i> only relevant to technology, it may need to be</p>	3 5

#	Description of Issue	AEWG Views	Recommended Action(s)
	reliability of information used in performing audit procedures.	considered as part of broader actions related to ISA 330.	
30	Evolution in <b>technology</b> has increased the risk of auditors over-relying on technology used to perform audit procedures, and heightened the need for the standard to emphasize that the auditor should consider whether the audit procedures are responsive to the risks of material misstatement and the assertions being tested.	The AEWG is of the view that the risk of overreliance on technology could be highlighted in the standard or in guidance.	1.1 3 4 5
31	The use of <b>technology</b> that enables the analysis of larger populations has raised questions about whether the auditor is required to follow up all exceptions identified, or whether the auditor is able to perform further testing only on a selection of exceptions, provided that the risk of material misstatement in the remaining population is at an acceptably low level. (See item 41)	The AEWG agrees that further clarification is needed regarding this issue. However, the AEWG is of the view that the issue is <i>not</i> only relevant to technology (it could also be relevant to analytical procedures not performed through the use of technology). Therefore, this issue may need to be considered as part of broader actions related to ISA 330.	3 5
32	Evolution in <b>technology</b> raises questions about whether ISA 330 should be updated to reflect new technology. For example: <ul style="list-style-type: none"> <li>• Paragraphs A4–A8 could be enhanced to describe how technology may affect the nature, timing and extent of further audit procedures.</li> <li>• Paragraph A24 could be updated to include more modern examples of when substantive procedures alone may not provide sufficient appropriate audit evidence.</li> <li>• The requirement in paragraph 10 regarding the nature and extent of tests of controls to obtain evidence about the operating effectiveness of controls may need updating for an automated environment, and may need to include factors such as the underlying data used to support the functioning of the control</li> </ul>	The AEWG recognizes that the standard could be modernized to include examples for technology.  However, some of these issues relate to the requirements, which may need to be considered as part of broader actions related to ISA 330.	3 4 5

#	Description of Issue	AEWG Views	Recommended Action(s)
	<p>and the algorithms used in the technology.</p> <ul style="list-style-type: none"> <li>• Paragraph A29 dealing with the consistency of IT processing may be outdated.</li> <li>• The requirements and application material dealing with audit evidence obtained in previous audits may need reconsideration, in particular the requirement in paragraph 13 that describes the factors to be considered in determining whether it is appropriate to use previous evidence.</li> </ul>		
33	<p>Evolution in <b>technology and the nature and number of sources of information</b> has given rise to questions about the testing of information used by the auditor in performing audit procedures to respond to the risk of material misstatement. (See item 11)</p>	<p>The AEWG recommends clarifying the linkage to ISA 500 regarding the use of information sources in performing audit procedures including, for example:</p> <ul style="list-style-type: none"> <li>• Clarifying that the nature and purpose of the audit procedure affects the required relevance and reliability of the information.</li> <li>• Explaining the need for appropriate planning for gathering audit evidence, for example, planning which information sources will be used and the criteria for that information, the tools and techniques to be used and the engagement team members who will apply the tools and techniques, and considering the degree to which the information achieves the planned criteria.</li> </ul>	<p>1.2 3 5</p>
34	<p>Refer to items 7–8 regarding sufficient appropriate audit evidence – these considerations also apply to paragraphs 25-27 of ISA 330.</p>	<p>The AEWG notes that the consideration of sufficient appropriate audit evidence is evaluated at various points throughout the audit, including in the context of ISA 330. Also refer to actions in items 7–8.</p>	<p>1.2 3 5</p>



#	Description of Issue	AEWG Views	Recommended Action(s)
<b>ISA 402, AUDIT CONSIDERATIONS RELATING TO AN ENTITY USING A SERVICE ORGANIZATION</b>			
35	<p>Evolution in <b>technology and the nature and number of sources of information</b> raises questions about whether ISA 402 should be updated to reflect new technology and information sources, for example:</p> <ul style="list-style-type: none"> <li>• Clarifying the scope of the standard regarding the entity's use of IT, including providing examples of when the use of technology by an entity or the use of new types of information sources may be considered a service organization (paragraphs A3 and A4). For example, is the use of a public blockchain considered a service organization, and if so, who is the service provider in such cases (e.g., the developer of the blockchain, or the parties processing transactions in the blockchain)? (See item 12)</li> <li>• Addressing practical challenges of obtaining an understanding of service organizations and updating the standard to reflect matters that may be considered in the context of technology.</li> <li>• Updating paragraph A1 to include other types of information sources that may exist in today's world.</li> </ul>	<p>The AEWG is of the view that guidance outside of the standards could clarify when an information source is a service organization. This would form part of the work on audit evidence, because it is related to the information used by the auditor in obtaining audit evidence. However, more specific guidance that addresses certain types of technologies could also be useful.</p> <p>The AEWG also recognizes that ISA 402 could be further modernized to reflect technology.</p>	<p>1.1 1.2 4</p>
<b>ISA 501, AUDIT EVIDENCE—SPECIFIC CONSIDERATIONS FOR SELECTED ITEMS</b>			
36	<p>Evolution in <b>technology and the nature and number of sources of information</b> raises questions about whether ISA 501 should be updated to reflect new technology and information sources, for example:</p> <ul style="list-style-type: none"> <li>• Paragraph 4 requires attendance at physical inventory counting, which may, in some circumstances, be undertaken remotely using new technology, such as drones. The application material also appears outdated in this regard.</li> </ul>	<p>The AEWG agrees that ISA 501 could be modernized, although some of the issues relate to technology, and others relate to audit evidence.</p> <p>The AEWG notes that certain technology may be used to address only specific requirements of the standard, for example, the use of a drone at a stock count does not enable the auditor to evaluate management's instructions and procedures for</p>	<p>3 4 5</p>

#	Description of Issue	AEWG Views	Recommended Action(s)
	<ul style="list-style-type: none"> <li>New types of information sources may provide information about litigation and claims, and the procedures described in paragraph 9 may inadvertently limit the extent to which auditors seek information from other sources.</li> </ul>	recording and controlling the results of the entity's physical inventory counting.	
<b>ISA 505, EXTERNAL CONFIRMATIONS</b>			
37	Evolution in <b>technology</b> and the nature and number of sources of <b>information</b> has raised questions about whether the definition of external confirmations remains appropriate. For example, there may be circumstances when a transaction is confirmed using technology through a counterparty or the confirmation is built into technology (e.g., confirmation in a blockchain).	The AEWG is of the view that further clarification is needed about what audit procedures would qualify as a confirmation, and that further consideration is needed of the definition of "confirmation". The AEWG is of the view that the issue relates to audit evidence (i.e., the information used by the auditor in arriving at the conclusions on which the auditor's opinion is based).	3 5
38	Evolution in <b>technology</b> and the nature and number of sources of <b>information</b> has resulted in descriptions in ISA 505 becoming outdated. For example, paragraph A12 refers to facsimile or electronic mail.	The AEWG recognizes this as a modernization issue that requires updates to the standard.	4 5
<b>ISA 510, INITIAL AUDIT ENGAGEMENTS – OPENING BALANCES</b>			
39	Evolution in technology used by auditors to perform audit procedures has raised questions about the ability of a successor auditor to fulfill the requirements of ISA 510 in relation to opening balances, in particular reviewing the predecessor auditor's working papers in circumstances when the predecessor auditor used proprietary technology to perform the procedures.	The AEWG is of the view that this issue is not unique to technology, and that ISA 510 provides alternative audit procedures that may be undertaken when it is not possible to review a predecessor auditor's working papers. Furthermore, the AEWG notes that while the predecessor auditor may be unable to provide access to a technology tool, they may be able to provide the output from the tool.	6
<b>ISA 520, ANALYTICAL PROCEDURES</b>			
40	Evolution in <b>technology and</b> the nature and number of sources of <b>information</b> , in particular the use of data analytic tools, raises questions	The AEWG is of the view that: <ul style="list-style-type: none"> <li>The manner in which substantive audit procedures</li> </ul>	1.1 3 5

#	Description of Issue	AEWG Views	Recommended Action(s)
	<p>about whether ISA 520 should be updated to reflect the use of new technology and information sources in performing analytical procedures. For example, technology and information sources raises questions about:</p> <ul style="list-style-type: none"> <li>• The scope of the standard, such as whether it should more broadly apply to all analytical procedures, including those performed to identify risks (which may be dual purpose in some cases).</li> <li>• What is meant by the term “expectation,” which could include amounts, ratios or trends.</li> <li>• The requirement to determine the amount of any difference of recorded amounts from expected values, as this requirement could be perceived as limiting in the context of the varying types of analytical procedures that may be performed and the expectations that are developed.</li> <li>• Whether the application material should include more modern examples of data analytic tools, and how these relate to the consideration factors. For example, the application material could address the use of visualization and how the proportion of graphs could impact the auditor’s judgments.</li> </ul>	<p>are described in ISA 520 may create perceptions that the standard is limited to substantive analytical procedures (see paragraph 5) and may exclude analytical procedures used by the auditor as both a risk assessment procedure and substantive analytical procedure.</p> <ul style="list-style-type: none"> <li>• More emphasis could be given to the fact that in the case of a substantive analytical procedure, the auditor’s focus is on detection risk (i.e., whether the procedure is designed to detect a misstatement that could be material).</li> <li>• Further clarification is needed of what is meant by “expectation” and how the auditor determines whether the amount of a difference is acceptable.</li> </ul> <p>The AEWG is of the view that the issues are not solely related to technology (with the exception of more modern examples of tools), as they could also be relevant when using other tools and techniques. However, given the importance of these issues, guidance may be an appropriate action at this time.</p>	
41	<p>The use of <b>technology</b> in performing analytical procedures has raised questions about whether the auditor is required to follow up all exceptions identified, or whether the auditor is able to perform further testing only on a selection of exceptions, provided that the risk of a material misstatement in the remaining population is at an acceptably low level. (See item 31)</p>	<p>The AEWG agrees that further clarification is needed regarding this issue. However, the AEWG is of the view that the issue is <i>not</i> only relevant to technology (it could also be relevant to analytical procedures not performed through technological tools). However, given the importance of this issue,</p>	<p>1.1 3 5</p>

#	Description of Issue	AEWG Views	Recommended Action(s)
		guidance may be an appropriate action at this time.	
42	The factors considered in the evaluation of the <b>reliability of information</b> are different in ISA 500 and ISA 520, which creates confusion about the attributes of information that affect the reliability of information. (See item 15)	The AEWG is of the view that the difference is due to the specific nature of analytical procedures dealt with in ISA 520. Therefore, the AEWG is of the view that the use of different factors is appropriate.	1.2 6
<b>ISA 550, RELATED PARTIES</b>			
43	<p>Evolution in <b>technology and</b> the nature and number of sources of <b>information</b> raises questions about whether ISA 550 should be updated to reflect new technology and information sources, for example:</p> <ul style="list-style-type: none"> <li>• The application material could recognize the use of technology to assist in identifying related party relationships and transactions, for example, data analytic tools may be able to analyze large volumes of data and may highlight trends that may indicate such relationships.</li> <li>• The application material could recognize the use of technology to test related party transactions, for example, tools that can compare the terms of transactions to arm's length transactions, or that analyze the population of transactions for authorization.</li> </ul>	The AEWG recognizes this as a modernization issue that requires updates to the standard.	4
44	Evolution in <b>technology</b> may create new risks regarding related parties. For example, with the use of blockchain, there may be new risks regarding unidentified related parties.	The AEWG noted regulators' increased interest in unidentified related parties as a result of new technology, and that guidance on this topic may be useful.	1.1
<b>ISA 560, SUBSEQUENT EVENTS</b>			
45	Evolution in <b>technology and the nature and number of sources of information</b> raises questions about whether ISA 560 should be	The AEWG recognizes this as a modernization issue that requires updates to the standard.	4

#	Description of Issue	AEWG Views	Recommended Action(s)
	<p>updated to reflect new technology and information sources, for example:</p> <ul style="list-style-type: none"> <li>The audit procedures described in paragraph A8 could include new types of procedures that use technology, for example, data analytic tools that are able to analyze information and identify any subsequent events.</li> <li>New types of information sources may provide information about subsequent events (e.g., social media).</li> </ul>		
<b>ISA 570 (REVISED), GOING CONCERN</b>			
46	<p>Evolution in <b>technology and the nature and number of sources of information</b> raises questions about whether ISA 570 (Revised) should be updated to reflect new technology and information sources, for example:</p> <ul style="list-style-type: none"> <li>The audit procedures described in paragraph A16 could include new types of procedures that use technology, for example, AI tools that are able to predict outcomes using a variety of data inputs, both internal and external, or tools that are able to read contracts to verify the terms and conditions of contracts have been met.</li> <li>New types of information sources that may provide an indication of whether events or conditions exist that could cast doubt on the entity's ability to continue as a going concern.</li> </ul>	The AEWG recognizes this as a modernization issue that requires updates to the standard.	4
<b>ISA 600, SPECIAL CONSIDERATIONS—AUDITS OF GROUP FINANCIAL STATEMENTS (INCLUDING THE WORK OF COMPONENT AUDITORS)</b>			
47	<p>Evolution in <b>technology</b>, and the extent to which it is used by the entity and the auditor, raises questions about whether ISA 600 should be updated to reflect the special considerations in, for example:</p> <ul style="list-style-type: none"> <li>Using technology to understand the group, its components and their</li> </ul>	The AEWG is of the view that technology presents unique challenges and opportunities in the context of group audits, and since the standard is currently under revision, further coordination should be undertaken between the ISA 600 Task	2 (ISA 600 TF)

#	Description of Issue	AEWG Views	Recommended Action(s)
	<p>environments and to identify risks of material misstatement.</p> <ul style="list-style-type: none"> <li>The entity's use of technology, or the auditor's automated tools and techniques, in determining the most appropriate responses to assessed risks of material misstatement, including procedures to be performed with respect to different components.</li> <li>The effect of technology on controls (including group-wide controls).</li> <li>The use of multiple IT systems across the group, including the effect of technology on the entity's financial reporting process (e.g., understanding and testing the consolidation process).</li> </ul>	Force and TWG on whether and how to incorporate technology in the standard.	
<b>ISA 620, USING THE WORK OF AN AUDITOR'S EXPERT</b>			
48	<p>Evolution in <b>technology</b>, and the extent to which it is used by the entity and the auditor, has raised questions about:</p> <ul style="list-style-type: none"> <li>Who is considered an auditor's expert and whether they fall within the scope of ISA 620, or whether they are considered a member of the engagement team. (See item 18)</li> <li>The practicalities of the auditor having an understanding of the field of expertise of the auditor's expert, as required by paragraph 10, given the complexity of technology (e.g., the complexity of the algorithms used).</li> </ul>	<p>The AEWG is of the view that clarification of the difference between an auditor's expert, information source and when a technology specialist is a member of the engagement team would be useful. The AEWG notes that the definition of "engagement team" has been addressed in ED-220. The AEWG plans to ensure that appropriate coordination is undertaken with the ISA 220 Task Force.</p> <p>The AEWG notes that the auditor is expected to have a sufficient understanding of the field of expertise of the auditor's expert. Guidance may assist in applying this requirement to technology.</p>	1.1 3
<b>ISA 701, COMMUNICATING KEY AUDIT MATTERS IN THE INDEPENDENT AUDITOR'S REPORT</b>			
49	In describing how a key audit matter was addressed in the audit, expectation gaps may be created on how much audit evidence has been obtained and the level of assurance	As highlighted previously, the AEWG is of the view that "100% testing" is a misperception. However, the AEWG is of the view that when describing how	2 (ARIWG)

#	Description of Issue	AEWG Views	Recommended Action(s)
	provided, because auditors may indicate that “100% of the population was tested” when using technology on the audit.	the key audit matter was addressed in the audit, there should be caution that it is not in a manner that causes overconfidence in the procedures undertaken by the auditor. The AEWG is further of the view that caution in describing audit procedures is not unique to technology and therefore is not an issue that is best addressed through actions related to technology. Given that the Auditor Reporting Implementation Working Group is currently developing a post-implementation review plan, which may include further guidance, the AEWG intends to collaborate with that group on whether and how to address this issue.	
50	Evolution in <b>technology</b> and the nature and number of sources of <b>information</b> raises questions about whether ISA 701 should be updated to reflect new technology. For example, the application material describing how the auditor may determine key audit matters could include examples about technology related issues (e.g., audit of crypto assets or higher risks associated with technology such as the use of an AI tool).	The AEWG agrees that examples of technology-related key audit matters and how these are described in the auditor’s report would be useful.	1.1
<b>ISA 705 (REVISED), MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR’S REPORT</b>			
51	Evolution in <b>technology</b> and the nature and number of sources of <b>information</b> raises questions about whether ISA 705 (Revised) should be updated to reflect new technology. For example, the application material addressing examples of limitation of scope could include examples when the auditor was unable to obtain sufficient appropriate audit evidence given limitations on the availability of information generated by technology, or	The AEWG agrees that a limitation on the scope of the audit due to technology is an example that could be provided.	1.1

#	Description of Issue	AEWG Views	Recommended Action(s)
	limitations on determining the reliability of information used as audit evidence.		



## Appendix 3

### Summary of Possible Actions

The aim of this appendix is to list the issues as they have been identified in Appendix 2 under each of the proposed actions (i.e., a possible inventory of issues per proposed action). It should be noted that the itemization in Appendix 2 includes all possible actions per issue and that the AEWG is not proposing that all actions are followed for each issue. This Appendix 3 represents a different perspective to viewing the identified issues and possible actions so that the IAASB can provide input on which actions should be initiated at this time and the proposals about how they will be implemented. As these actions are initiated, additional issues may be identified to be addressed under these actions, or it may be determined that certain issues may only be addressed under a specific action or allocated to a different action.

Issue No.	Standard	Summary of issue to be considered
<b>Action Item 1.1: Guidance Addressing the Effect of Technology when Applying Certain Aspects of the ISAs</b>		
3	ISA 500	Clarifying the meaning of “information (to be used as audit evidence)”, “evidence” in general as used in IAASB standards other than the ISAs and “audit evidence” and exploring the need for a definition of “audit procedures.”
5	ISA 500	Clarifying whether an audit procedure can be both a risk assessment procedure and a substantive procedure.  Emphasizing that the purpose of the procedure needs to be established when designing the audit procedure and other ISAs apply in circumstances when a procedure is both a risk assessment procedure (ISA 315 (Revised)) and a substantive procedure (e.g., ISA 330 and ISA 520).
6	ISA 500	Addressing overreliance on technology by highlighting the need for professional skepticism in applying the audit procedure.
10	ISA 500	Addressing overreliance on certain information sources, such as blockchains.
12	ISA 500	Clarifying when an information source generated by certain technologies is a service organization (e.g., blockchain).  Addressing the following issues related to the reliability of information: <ul style="list-style-type: none"> <li>• The extent to which an auditor may use information generated by AI, particularly when it is based on unstructured machine learning.</li> <li>• How the auditor may determine that the information generated by AI is appropriate.</li> </ul>
24	ISA 230	Addressing documentation challenges specific to certain types of technology, such as AI.
25	ISA 240	Addressing the impact of technology on fraud.
27	ISA 300	Addressing the planning considerations when using technology to perform the audit procedures, or when the client is using technology.

Issue No.	Standard	Summary of issue to be considered
28	ISA 320	Clarifying that performance materiality always applies, even when a large portion of the population is analyzed or tested.
30	ISA 330	Addressing overreliance on technology used to perform audit procedures and emphasizing that the auditor should consider whether the audit procedures are responsive to the risks of material misstatement and the assertions being tested.
35	ISA 402	Clarifying when an information source generated by certain technologies is a service organization (e.g., blockchain).
40	ISA 520	Addressing analytical procedures used by the auditor as both a risk assessment procedure and substantive analytical procedure.  Emphasizing the fact that in the case of a substantive analytical procedure, the auditor's focus is on detection risk. Clarifying what is meant by "expectation" and how the auditor determines whether the amount of a difference is acceptable.
41	ISA 520	Clarifying whether the auditor is required to follow up all exceptions identified, or whether the auditor is able to perform further testing only on a selection of exceptions, provided that the risk of material misstatement in the remaining population is at an acceptably low level.
44	ISA 550	Addressing unidentified related parties as a result of new technology.
48	ISA 620	Guidance in applying the requirement regarding the auditor's understanding of the field of expertise of the auditor's expert, in relation to the use of a technology expert.
50	ISA 701	Examples of technology-related key audit matters and how these are described in the auditor's report.
51	ISA 705	Including a limitation on the scope of the audit due to technology as an example auditor's report.
<b>Action Item 1.2: Guidance Addressing Audit-Evidence-Related Issues when Applying Certain Aspects of the ISAs</b>		
4	ISA 500	Clarifying how the ISAs may be applied to the use of new tools and techniques in the context of the categories of audit procedures and nature of audit procedures.
5	ISA 500	Clarifying whether an audit procedure can be both a risk assessment procedure and a substantive procedure.  Emphasizing that the purpose of the procedure needs to be established when designing the audit procedure and other ISAs apply in circumstances when a procedure is both a risk assessment procedure (ISA 315 (Revised)) and a substantive procedure (e.g., ISA 330 and ISA 520).
6	ISA 500	Addressing overreliance on technology by highlighting the need for professional skepticism in applying the audit procedure.

Issue No.	Standard	Summary of issue to be considered
7	ISA 500	Addressing professional skepticism in the context of judgments made about sufficient appropriate audit evidence by describing what factors would prompt an auditor to seek further audit evidence from additional sources.
11	ISA 500	Emphasizing or clarifying the matters considered by the auditor when considering the relevance and reliability of information.
12	ISA 500	Clarifying when an information source is a service organization, including more specific guidance addressing certain types of information sources or technologies (e.g. blockchain).  Addressing the following issues related to the reliability of information: <ul style="list-style-type: none"> <li>• The extent to which an auditor may use information generated by AI, particularly when it is based on unstructured machine learning.</li> <li>• How the auditor may determine that the information generated by AI is appropriate.</li> </ul>
14	ISA 500	Exercising professional skepticism in circumstances when there is information that contradicts management’s assertions but the reliability of that information may not be determinable.
15	ISA 500	Clarifying the differences in the factors considered in the evaluation of the reliability of information between ISA 500 and ISA 520.
18	ISA 500	Further clarifying the difference between a management’s expert and external information source and also clarifying the difference between an auditor’s expert, information source and when a technology specialist is a member of the engagement team.
19	ISA 500	Clarifying when ISA 530 is applicable.  Addressing issues regarding auditors’ application of sampling techniques under ISA 530 and the auditor’s consideration of sufficient appropriate audit evidence.
20	ISA 500	Clarifying how contradictory evidence is related to inconsistent evidence.  Clarifying how the principles of the IESBA Code apply in the context of the audit.
33	ISA 330	Clarifying the linkage to ISA 500 regarding the use of information sources in performing audit procedures including clarifying that the nature of the audit procedure and its purpose affects the required relevance and reliability of information, and explaining the need for planning regarding the information source.
34	ISA 330	Addressing professional skepticism in the context of judgments made about sufficient appropriate audit evidence by describing what factors would prompt an auditor to seek further audit evidence from additional sources.
35	ISA 402	Clarifying when an information source is a service organization.

Issue No.	Standard	Summary of issue to be considered
42	ISA 520	Clarifying the differences in the factors considered in the evaluation of the reliability of information between ISA 500 and ISA 520.
<b>Action Item 2: Matters that are Relevant to a Current Project</b>		
5	ISA 500	Whether an audit procedure can be both a risk assessment procedure and a substantive procedure. (Collaborate with ISA 315 (Revised) Task Force)
11	ISA 500	The relevance and reliability of information. (Collaborate with ISA 315 (Revised) Task Force)
16	ISA 500	The extent to which the auditor needs to have an understanding of general IT controls and application controls. (Collaborate with ISA 315 (Revised) Task Force)
18	ISA 500	When a technology specialist is a member of the engagement team. (Collaborate with ISA 220 Task Force)
47	ISA 600	Incorporating technology into ISA 600. (Collaborate between the ISA 600 Task Force and TWG)
49	ISA 701	Caution about describing procedures in key audit matters in a manner that causes overconfidence in the procedures. (Highlight as a matter for consideration as part of the auditor reporting post-implementation review)
<b>Action Item 3: A Project to Revise the Standards to Address Audit Evidence</b>		
1	ISA 500	Clarifying whether ISA 500 is a performance standard, or a foundational standard that is applicable to the other ISAs.
2	ISA 500	Modernization of the standard to reflect technology.
3	ISA 500	Clarifying the meaning of “information (to be used as audit evidence)”, “evidence” in general as used in IAASB standards other than the ISAs and “audit evidence” and exploring the need for a definition of “audit procedures.”
4	ISA 500	Clarifying how the ISAs may be applied to the use of new tools and techniques in the context of the categories of audit procedures and nature of audit procedures.
5	ISA 500	Clarifying whether an audit procedure can be both a risk assessment procedure and a substantive procedure.  Emphasizing that the purpose of the procedure needs to be established when designing the audit procedure and other ISAs apply in circumstances when a procedure is both a risk assessment procedure (ISA 315 (Revised)) and a substantive procedure (e.g., ISA 330 and ISA 520).
6	ISA 500	Addressing overreliance on technology by highlighting the need for professional skepticism in applying the audit procedure.

Issue No.	Standard	Summary of issue to be considered
7	ISA 500	Addressing professional skepticism in the context of judgments made about sufficient appropriate audit evidence by describing what factors would prompt an auditor to seek further audit evidence from additional sources.
8	ISA 500	Clarifying the concepts of “appropriate audit evidence” and “sufficient audit evidence.”  Clarifying that the factors considered by the auditor in determining whether sufficient appropriate audit evidence has been obtained are considered at various points throughout the audit.
9	ISA 500	Addressing the factors that may be considered by an auditor in considering the reliability of information to be used as audit evidence.
10	ISA 500	Modernization of the standard to reflect new information sources.
11	ISA 500	Emphasize or clarify the matters considered by the auditor when considering the relevance and reliability of information. Also address inconsistencies in terminology in the standard.
12	ISA 500	Clarifying when an information source is a service organization.
13	ISA 500	Modernization to address differentiation in work effort regarding the reliability of information between information produced by the entity and other information sources.
14	ISA 500	Exercising professional skepticism in circumstances when there is information that contradicts management’s assertions but the reliability of that information may not be determinable.
18	ISA 500	Further clarifying the difference between a management’s expert and external information source, and also clarifying the difference between an auditor’s expert, information source and when a technology specialist is a member of the engagement team.
19	ISA 500	Clarifying when ISA 530 is applicable.  Addressing issues regarding auditors’ application of sampling techniques under ISA 530 and the auditor’s consideration of sufficient appropriate audit evidence.
20	ISA 500	Clarifying how contradictory evidence is related to inconsistent evidence.  Clarifying how the principles of the IESBA Code apply in the context of the audit.
29	ISA 330	Overreliance on controls over the preparation of information and emphasizing considerations about the relevance and reliability of information used in performing audit procedures.
30	ISA 330	Overreliance on technology used to perform audit procedures and emphasizing that the auditor should consider whether the audit procedures are responsive to the risks of material misstatement and the assertions being tested.

Issue No.	Standard	Summary of issue to be considered
31	ISA 330	Clarifying whether the auditor is required to follow up all exceptions identified, or whether the auditor is able to perform further testing only on a selection of exceptions, provided that the risk of material misstatement in the remaining population is at an acceptably low level.
32	ISA 330	Possible revisions to reflect technology, including additional factors to be considered in obtaining evidence about the operating effectiveness of controls, and in determining whether it is appropriate to use evidence from previous audits.
33	ISA 330	Clarifying the linkage to ISA 500 regarding the use of information sources in performing audit procedures including clarifying that the nature of the audit procedure and its purpose affects the required relevance and reliability of information, and explaining the need for planning regarding the information source.
34	ISA 330	Addressing professional skepticism in the context of judgments made about sufficient appropriate audit evidence by describing what factors would prompt an auditor to seek further audit evidence from additional sources.
36	ISA 501	Modernizing the standard to reflect new types of information sources.
37	ISA 505	Clarifying what audit procedures would qualify as a confirmation. Considering the definition of “confirmation”.
40	ISA 520	Addressing analytical procedures used by the auditor as both a risk assessment procedure and substantive analytical procedure.  Emphasizing the fact that in the case of a substantive analytical procedure, the auditor’s focus is on detection risk. Clarifying what is meant by “expectation” and how the auditor determines whether the amount of a difference is acceptable.
41	ISA 520	Clarifying whether the auditor is required to follow up all exceptions identified, or whether the auditor is able to perform further testing only on a selection of exceptions, provided that the risk of material misstatement in the remaining population is at an acceptably low level.
48	ISA 620	Clarifying the difference between an auditor’s expert, information source and when a technology specialist is a member of the engagement team.
<b>Action Item 4: A Targeted Project to Address Relevant Aspects of Technology Across the ISAs</b>		
2	ISA 500	Modernizing the standard to reflect technology.
21	ISA 200	Modernizing the standard to reflect technology.
22	ISA 210	Modernizing the standard to reflect technology.
23	ISA 230	Modernizing the standard to reflect technology.
24	ISA 230	Exploring the need to focus on the degree to which documentation supports an understanding of the conclusions reached.

Issue No.	Standard	Summary of issue to be considered
25	ISA 240	Modernizing the standard to reflect technology.
26	ISA 265	Modernizing the standard to reflect technology.
27	ISA 300	Modernizing the standard to reflect technology.
30	ISA 330	Overreliance on technology used to perform audit procedures and emphasizing that the auditor should consider whether the audit procedures are responsive to the risks of material misstatement and the assertions being tested.
32	ISA 330	Modernization to the standard to reflect technology, including additional factors to be considered in obtaining evidence about the operating effectiveness of controls, and in determining whether it is appropriate to use evidence from previous audits.
35	ISA 402	Modernizing the standard to reflect technology.
36	ISA 501	Modernizing the standard to reflect technology.
38	ISA 505	Modernizing the standard to reflect technology.
43	ISA 550	Modernizing the standard to reflect technology.
45	ISA 560	Modernizing the standard to reflect technology.
46	ISA 570	Modernizing the standard to reflect technology.
<b>Action Item 5: The Issue is Acknowledged and will be Considered as Part of the IAASB's Forward Work Plan</b>		
16	ISA 330	Addressing IT with respect to testing controls, and the impact of deficiencies in these controls on the reliability of information.
19	ISA 530	Addressing issues regarding auditors' application of sampling techniques under ISA 530 and the auditor's consideration of sufficient appropriate audit evidence.
29	ISA 330	Overreliance on controls over the preparation of information and emphasizing considerations about the relevance and reliability of information used in performing audit procedures.
30	ISA 330	Overreliance on technology used to perform audit procedures and emphasizing that the auditor should consider whether the audit procedures are responsive to the risks of material misstatement and the assertions being tested.
31	ISA 330	Clarifying whether the auditor is required to follow up all exceptions identified, or whether the auditor is able to perform further testing only on a selection of exceptions, provided that the risk of material misstatement in the remaining population is at an acceptably low level.
32	ISA 330	Modernization to the standard to reflect technology, including additional factors to be considered in obtaining evidence about the operating effectiveness of controls, and in determining whether it is appropriate to use evidence from previous audits.

Issue No.	Standard	Summary of issue to be considered
33	ISA 330	Clarifying the linkage to ISA 500 regarding the use of information sources in performing audit procedures including clarifying that the nature of the audit procedure and its purpose affects the required relevance and reliability of information, and explaining the need for planning regarding the information source.
34	ISA 330	Addressing professional skepticism in the context of judgments made about sufficient appropriate audit evidence by describing what factors would prompt an auditor to seek further audit evidence from additional sources.
36	ISA 501	Modernizing the standard to reflect technology.
37	ISA 505	Clarifying what audit procedures would qualify as a confirmation. Considering the definition of “confirmation”.
38	ISA 505	Modernizing the standard to reflect technology.
40	ISA 520	Addressing analytical procedures used by the auditor as both a risk assessment procedure and substantive analytical procedure.  Emphasizing the fact that in the case of a substantive analytical procedure, the auditor’s focus is on detection risk. Clarifying what is meant by “expectation” and how the auditor determines whether the amount of a difference is acceptable.
41	ISA 520	Clarifying whether the auditor is required to follow up all exceptions identified, or whether the auditor is able to perform further testing only on a selection of exceptions, provided that the risk of material misstatement in the remaining population is at an acceptably low level.
<b>Action Item 6: The Matter is Presently not Considered an Issue</b>		
15	ISA 500	Differences in the factors considered in the evaluation of the reliability of information between ISA 500 and ISA 520.
17	ISA 500	Distinguishing between information and data in the standards.
28	ISA 320	Concept of performance materiality in circumstances when 100% of the population is tested, or a significant portion.
39	ISA 510	Reviewing the predecessor auditor’s working papers in circumstances when the predecessor auditor used proprietary technology to perform the procedures.
42	ISA 520	Differences in the factors considered in the evaluation of the reliability of information between ISA 500 and ISA 520.





## AUASB Board Meeting Summary Paper

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### AGENDA ITEM NO.

**Meeting Date:** 12 June 2019  
**Subject:** Agreed-Upon Procedures  
**Date Prepared:** 4 June 2019

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Action Required

For Information Purposes Only

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### Agenda Item Objectives

1. To inform the AUASB on the progress of the international revision to ISRS 4400 *Agreed-Upon Procedures Engagements*, with particular reference to the 3 areas of AUASB concern being professional judgement, independence and restriction on use.

### Background

1. The AUASB provided their submission on ED- ISRS 4400 *Agreed-Upon Procedures Engagements* to the IAASB in March 2019.
2. The AUP IAASB taskforce have analysed feedback from stakeholders and are seeking IAASB input in several areas to finalise the revised standard.
3. The June 2019 IAASB meeting papers on AUPs, can be found [[here](#)].

### Summary Position

#### 1. **Judgement:**

- (a) The AUASB emphasised in their submission to the IAASB that practitioners should not exercise professional judgement in relation to the conduct of procedures. The Task Force continues to support the position adopted in ED-4400 that professional judgment is relevant in an AUP engagement. However, the taskforce acknowledges that the exercise of professional judgment when performing the procedures needs further investigation and is open for discussion at the IAASB meeting in June 2019.

#### 2. **Independence:**

- (a) The AUASB supported the proposed ED 4400 not including a precondition for the practitioner to be independent. However, the AUASB considered that ED 4400 should

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include an explicit reference to the fundamental principles of the Code when reporting on AUP engagements, in particular as a minimum the practitioners' requirement to be objective under the Code. In light of the strong support for the approach as proposed in ED-4400—that is, not including a precondition for the practitioner to be independent and not requiring the practitioner to determine independence (if the practitioner is not otherwise required to be independent), the Task Force proposes to retain the approach in ED-4400, which is consistent with the AUASB submission to the IAASB.

- (b) In relation to disclosures, the AUASB considered that the AUP report should not contain any 'negative' statements that may cause confusion to users of the AUP report.: Refer table below - the taskforce is presenting 2 alternative disclosure positions to the IAASB for deliberation at the June 2019 IAASB meeting. Alternative 1 is in alignment with the AUASB submission to the IAASB.

		Is practitioner required to be independent?	
		Yes	No
Is practitioner independent?	Unknown (i.e., not determined)	N/A: Practitioner is not able to perform the engagement because the practitioner has not determined independence.	<p>Alternative 1: Statement that the practitioner is not required to be independent.</p> <p>Alternative 2: Statement that the practitioner is not required to be independent and that the practitioner has not determined independence.</p>
	Yes	Statement that the practitioner is independent and the basis therefor (i.e., the independence criteria against which the practitioner determined independence).	<ul style="list-style-type: none"> <li>Statement that the practitioner is independent and the basis therefor (i.e., the independence criteria against which the practitioner determined independence).</li> </ul>
	No	Not applicable: Practitioner is not able to perform the agreed-upon procedures engagement because the practitioner is not independent.	<p>Alternative 1: Statement that the practitioner is not required to be independent.</p> <p>Alternative 2: Statement that, although the practitioner is not required to be independent, the practitioner is not independent. Explanation as to why the practitioner is not independent.</p>

### 3. Restriction of use

- (a) The AUASB considered that the use of an AUP report should be restricted to parties that have agreed to the procedures performed **or have been identified as intended users in the report**. The majority of respondents to the international ED agreed with no

restriction of use and based on this, the Task Force agreed that the approach of not requiring a restriction of distribution or use to be placed on the AUP report remains appropriate. The Task Force noted the following on the issue of restriction of use versus restriction on distribution:

- (i) It may be practicable to restrict the use of the AUP report but not the distribution of the report. Effectively restricting the distribution of the AUP report may be difficult in light of modern technology and possible legal or regulatory requirements for the AUP report to be made available publicly.
- (ii) In some common law jurisdictions, it is possible to restrict the use of the AUP report but not its distribution. In some civil law jurisdictions, it is possible to restrict the distribution of the AUP report but not its use.

The task force will consider developing application material to explain why neither a restriction on use nor a restriction on distribution can be mandated in the standard.

- (b) The proposals by the taskforce are not consistent with the AUASB submission to the IAASB.

### **Next Steps**

The Task Force will consider all the respondents' comments on ED-4400 and the IAASB's directions at the June 2019 meeting in developing the post-exposure draft of ISRS 4400 (Revised). The Task Force plans to have the first read of the post-exposure draft of ISRS 4400 (Revised) ready for presentation to the Board by September 2019. The first read of the post-exposure draft will be presented to the Board September if time permits, or at a subsequent meeting when there is time available on the Board's agenda. The Task Force is working towards approval of final ISRS 4400 (Revised) in late 2019 or early 2020.

# AUASB Board Meeting Summary Paper

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**AGENDA ITEM NO.**        **2.6**  
**Meeting Date:**            12 June 2019  
**Subject:**                    Auditor Reporting Implementation Review  
**Date Prepared:**            3 June 2019

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**Action Required**

**For Information Purposes Only**

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## Agenda Item Objectives

1. At the June 2019 IAASB meeting the Auditor Reporting Implementation Working Group (ARIWG) is providing an update to the IAASB on:
  - an overview of global trends and key themes from research observed by the ARWIG to date;
  - the plans for the Auditor Reporting Post-Implementation Review (PIR).

Consistent with the International strategy the objective of this agenda item is for the AUASB to discuss and provide feedback / views on the ARIWG's plans for the PIR.

## Background

2. The Auditor Reporting Standards (Standards) have been in effect since December 2016. The IAASB focused initially on implementation support and monitoring the adoption of the Standards. The IAASB now focuses on PIR activities.
3. At this this meeting the ARIWG have provided an overview of global trends and key themes identified from research to date, and an updated PIR plan. The IAASB are being asked to:
  - consider the feedback/evidence gathered by the ARIWG to date, share relevant insights about the implementation experience with the auditor reporting standards that have not been identified or are inconsistent with this; and
  - approve and provide direction on the PIR plan including the scope, objectives and approach.
4. The AUASB Technical Group (ATG) have been observing the Australian implementation experience, and have conducted outreach and sought feedback from Australian stakeholders. Appendix A includes observations to date to assist the AUASB when considering the international feedback. Further outreach will need to be performed as part of the IAASB PIR.

## **Evidence gathered by the IAASB to date**

### ***Global trends identified by the IAASB***

5. The ARIWG have been monitoring the adoption of the Standards and have provided the following summary of global trends:
- Some jurisdictions are encouraging or mandating more extensive application of ISA 701, i.e. the inclusion of key audit matters (KAMs) for entities other than listed entities.
  - Some jurisdictions had imposed additional reporting requirements, such as the communication of matters related to independence, provision of non-audit services, audit scope and materiality, and inclusion of key observations about KAMs (i.e. outcome of audit procedures related to these matters), when relevant.
  - In the UK:
    - (i) the Financial Reporting Council (FRC) is currently consulting on increasing the auditor's responsibilities related to going concern, and new requirements for the auditor to communicate more on what they have done
    - (ii) The Kingman Review has recommended that the FRC consider requiring the inclusion of "graduated findings" in auditor's reports ("graduated findings" are described as judgmental views by the auditor on the KAMs, for example, describing an estimate as being cautious, balanced or optimistic).

### ***Global research / feedback to date***

6. The ARIWG have been monitoring relevant research and publications that included surveys of management, those charged with governance and shareholders, as well as desktop reviews of auditor's reports to identify trends in KAMs communicated (e.g., average number of KAMs, nature of KAMs and KAMs across industries).
7. Most of the publications highlighted the benefits of KAMs across stakeholders groups (TCGW, management and users). Other findings:
- KAMs have promoted more robust discussions among management, TCWG and auditors.
  - There appears to be an improvement in the disclosure in the financial statements on the matters to which the KAMs relate.
  - Some publications highlighted misconceptions about KAMs, for example, that a high number of KAMs are an indication that the entity is poorly managed or might have more problems compared with similar entities with fewer KAMs.
  - Generally, the publications highlight that users have found the KAMs useful as they provide transparency about the audit and highlight areas of attention for users, including helping users to navigate the financial statements and better understand the risks associated with their investments.
  - With respect to the informative nature of the KAMs, some reports noted that the KAMs that users found the most informative relate to those:

- (i) Not related to the financial statements (e.g., KAMs about the high turnover of staff in key financial roles).
- (ii) Linked to the entity's strategic goals or wider macro-economic or environmental factors.
- (iii) Highlighting the reliance of the entity and the auditor on complex IT systems and controls.

In reports that considered subsequent years, it was noted that explanations about changes in the audit approach or KAM from the previous audit were particularly useful.

- Some of the publications explored stakeholders' views on the other information disclosures in the auditor's reports and found that those charged with governance and users considered that the new disclosures provided them with greater confidence about the other information. However, some of the feedback suggested a need for the auditor to provide an update on the other information received after the auditor's report has been issued

8. Some implementation challenges identified:

- Describing KAMs in an informative, yet succinct manner. There has been criticism that some are "boilerplate" i.e. described in a standardised manner.
- The interaction between the going concern paragraph, KAM and emphasis of matter paragraphs. This has been raised by Australian auditors. This highlights a possible need for further guidance to explain the interactions between ISA 570, ISA 701 and ISA 706.
- The ARIWG are aware of concerns with ISA 720 and have recommended that this standard needs to be focused on as part of the PIR. Refer to Appendix A for the concerns raised. This is consistent with concerns raised by Australian stakeholders.

9. Disclosures in the Auditor's Report beyond those required

- Outcome of audit procedures - For the most part, across all of the publications there was an indication that users of financial statements, especially investors, prefer that auditors include the outcome of audit procedures performed regarding KAMs because they are otherwise unable to assess whether management appropriately dealt with the matter.
- Materiality and the scope of the audit – this is currently required in the UK. Publications indicated varying views from users. When materiality is disclosed users noted that it would be more useful if more was disclosed such as rationale etc. and reasons for using or changing particular materiality benchmarks or changes in the overall materiality level year on year.

**Actions for the AUASB**

- 1) Refer to Appendix A for the ATG's observations to date in Australia.
- 2) Do you have any further insights or views about the Standards that have not been identified from the research above, or that are inconsistent with the trends observed by the ARIWG?

## Post Implementation Review plans

10. The ARIWG have revised the objectives of the PIR. These changes are not significant and have been provided for the AUASB's information.
11. Objective of the PIR (in track changes from the objectives previously approved)
- a) Determine whether the Standards are being consistently understood and implemented in a manner that achieves the IAASB's intended purpose in developing them so that the IAASB can determine what actions, if any, ~~changes~~ are needed:
  - b) To increase the consistency of practitioners' understanding of the Standards; and
  - c) For the Standards to achieve the intended purpose.
    - a. [Previously (d)] Identify how practical challenges and concerns are being addressed (by auditors, management and audit committees), and whether further action by the IAASB enhancements or refinements to the standards, or additional implementation support, is needed.
    - b. Understand the extent of global demand for additional information in the auditor's report ~~Determine whether further enhancements to the Standards are warranted~~ to improve the transparency of the audit (e.g., including the outcome of audit procedures with respect to KAMs, additional communications about going concern, the disclosure of materiality, and information about the scope of the audit).
    - d) Understand the extent of global demand for ~~Determine whether requiring~~ wider application of the requirements that currently apply only to audits of financial statements of ~~other than~~ listed entities (i.e. communication of KAM, the name of the engagement partner and, when applicable, communicating specific matters relating to other information) ~~would be in the public interest~~.
12. Scope of the PIR:
- Included in the scope of the PIR are ISA 700, 701, 705, 706, 720, 260 and 570 (auditor reporting aspects only).
  - The ARIWG is also looking for the IAASB's views on whether to extend to the reporting aspects of the IAASB's Other Standards i.e. whether to align the reporting requirements. Is there a demand for the reporting requirements of the IAASB's Other Standards to be aligned with the ISAs?
13. Approach to the PIR:
- The initial plan approved by the IAASB was to complete the PIR including finalising any actions / amendments to the Standards by the end of 2019. However the ARIWG's are asking the IAASB to support the recommendation to continue with ongoing monitoring and information gathering activities.
  - The ARIWG recognise that the information gathered to date has been from review of publications and research conducted, and that the IAASB should undertake further focused

information gathering activities so that there is an opportunity for all jurisdictions / stakeholders to provide input. The information gathering will cover:

- (i) General matters related to auditor reporting (KAMs, overall form and structure of the report, reporting of going concern matters).
- (ii) Whether to extend to other IAASB standards i.e. ISREs, ISAEs.
- (iii) ISA 720 – a separate focus area due to concerns raised (refer appendix B)

Refer to Appendix B for the topics and stakeholders the ARIWG plan to cover.

### **Actions / Questions for the AUASB**

- 1) Provide views on the planned approach to PIR.
- 2) Specifically do you agree that the focused information gathering activities are needed? Or is there sufficient information already gathered?
- 3) Do you agree with the proposed timing and the matters to be covered as outlined in Appendix C?
- 4) Do you agree with the ARIWG considering extending the auditor reporting aspects of the IAASB's other standards i.e. ISREs, ISAEs, ISRS?
- 5) Is there an indication of a need for the IAASB to take immediate action to respond to information already gathered globally (summarized in the "Global Trends" section of this paper), such as a project update, updating the Frequently Asked Questions publication, or other guidance?

### **ATG view**

Further information gathering is required especially when considering the following:

- further reporting by the auditor on outcomes of KAMs, materiality, scope of audit and increased disclosures related to going concern
- whether the structure and elements of other reports issued under the IAASB's standards (e.g., interim review reports) should be revisited.
- whether demand exists to extend the reporting of KAMs to all audits of financial statements (not just listed entities).

This needs to ensure there is demand for this, and consider the public interest benefit vs the cost.

### **Material Presented**

Agenda Item 2.6

AUASB Board Meeting Summary Paper



### Australian feedback gathered to date

The AUASB Technical Group (ATG) have been monitoring the implementation of the Standards in Australia and have conducted the following to gather feedback from Australian stakeholders:

- Worked with a Project Advisory Group to identify initial implementation issues and developed implementation FAQs;
- Met with representatives from the Big 6 Audit Firms to gather feedback on implementation / issues with the Standards based on the first year's experience. Their feedback is consistent with the challenges identified by the ARIWG in particular;
  - (i) Consistent feedback that ASA 720 is problematic;
  - (ii) The interaction between the going concern paragraph, KAM and emphasis of matter paragraphs needs to be relooked at and there should be flexibility for the auditor to report as they see appropriate.
- Included questions in the ACC survey and the investor survey targeted at gathering views on whether the new auditor's report had an impact on their views on audit quality;
  - (i) Feedback from ACC was Some / Minimal impact however the comments supported that this was because they have already been satisfied with their interactions with their auditor and the reporting of KAMs etc. did not impact this.
  - (ii) Feedback from investors was that the inclusion of KAMs had some impact on their perception of auditor quality. Also the quality of the information in the auditor's report (for example KAMs) was rated in the top 3 factors influencing perceptions on quality and the value of audit.
- Have discussed with ASIC who conducted a review of KAMs as part of their latest audit file inspection program. Their report includes an observation that there were instances where the descriptions of how a KAM was addressed were not evidenced in the file.
- Presented at ASIC's Audit Committee Chairs forum in 2018 and received feedback that ACCs agreed that reporting of KAMs was a very good improvement to the auditor's report, but the benefit was for users of the auditor's report.
- Reviewed a sample of auditor's reports to assess adoption of ASA 720.
- Have reviewed academic papers on the Auditor's report.

### Australian experience observed to date

Based on this the ATG believe that the implementation challenges identified by the ARWIG are accurate and specifically agree that the issues with ISA 720 in appendix A need to be addressed. In addition we have been informed that the cost of implementation was considerable and was not passed on entirely to clients.

We have observed that materiality and scope is being reported by PwC only. We are not aware if this is for all listed entities or not. We have not sought feedback on the users' views on the benefit of this reporting.

The ATG have not sought feedback from Australian stakeholders on extending the structure and elements of the enhanced auditor reporting to:

- The reporting of KAMs to other entities, such as PIEs;
- Requiring additional reporting by auditors on matters such as outcome of procedures on KAMs, or materiality and scope of the audit, going concern.

Prepared by the ARWIG

### **Summary of Challenges Identified with Respect to ISA 720 (Revised)**

ISA 720 (Revised) became effective for periods ending on or after December 15, 2016. In addition to changes addressing the auditor's responsibilities to consider the other information and respond appropriately when material inconsistencies appear, ISA 720 (Revised) introduced a new requirement for the auditor's report to include an "Other Information" section. Various questions related to ISA 720 (Revised) were included in the frequently asked questions publication released by the ARIWG in November 2016. However, feedback from outreach has highlighted a number of implementation issues as follows:

1. The determination of which documents constitute "other information," particularly when the individual components of the other information are not prepared and available at the same time, when additional voluntary information is included in the document, or when the document is not called an annual report.
2. The basis for selection of amounts or other items in the other information (that are intended to be the same as, to summarize, or to provide greater detail about, the amounts or other items in the financial statements) for comparison with the corresponding amounts or other items in the financial statements.
3. How the other information is described in the auditor's report, for example, whether the auditor refers to the "annual report" or more specifically to the components that make up the annual report.
4. How to address circumstances when the entity is not certain of what information will be included in the annual report.
5. How the auditor is expected to know that the other information has been finalized, since it may only be released after the financial statements and auditor's report.
6. How to apply the requirements of ISA 720 (Revised) to audits of financial statements prepared in accordance with a special purpose framework, and which often do not have other information that accompanies such financial statements.
7. Communication between the auditor, preparer and those charged with governance regarding responsibility for preparing the other information and the timing of providing the information to the auditor.

Prepared by the ARIWG

### **Draft Approach to Focused Information Gathering**

The table below sets out the matters that the ARIWG plans to explore with each stakeholder group. The way feedback would be solicited would be tailored for each stakeholder group and may include one or a combination of the following:

- (a) Direct meetings or discussions with the stakeholder.
- (b) Participation in the stakeholders' conferences or meetings (e.g., the IFIAR Standards Coordination Working Group annual meeting).
- (c) Surveys.
- (d) Presentations.

The ARIWG plans to further develop the plan for the focused information gathering in 2019, including the matters to be explored with each stakeholder group and how feedback will be solicited. The table below indicates the areas of focus for each stakeholder group (indicated with an X), but the topics may also be explored with other stakeholder groups.

Approach	Investors <sup>21</sup>	Regulators and other oversight authorities <sup>22</sup>	Preparers and TCWG <sup>23</sup>	NSS	Large Firms <sup>2</sup> 4	Small Firms <sup>25</sup>
<b>General matters related to auditor reporting</b>						
<ul style="list-style-type: none"> <li>Views about the new structure of the auditor's report and whether this has improved the communicative value of and transparency about the audit.</li> </ul>	X	X	X			
<ul style="list-style-type: none"> <li>Insightfulness and usefulness of the KAMs, and whether the communication of KAMs has met users' expectations.</li> </ul>	X	X	X			
<ul style="list-style-type: none"> <li>Whether the disclosure of the name of the engagement partner is useful.</li> </ul>	X	X	X			
<ul style="list-style-type: none"> <li>Usefulness of the separate section related to going concern in circumstances when a material uncertainty exists.</li> </ul>	X	X	X			
<ul style="list-style-type: none"> <li>Further possible improvements to the auditor's report to enhance the communication with users, including additional information that investors would find useful, such as the outcome of audit procedures that address KAMs, the disclosure of materiality, the scope of the audit and increased disclosures related to going concern (e.g., similar to UK proposals).</li> </ul>	X	X	X	X	X	X
<ul style="list-style-type: none"> <li>Whether the structure and elements of other reports issued under the IAASB's standards (e.g., interim review reports) should be revisited.</li> </ul>	X	X	X	X	X	X
<ul style="list-style-type: none"> <li>Whether demand exists for wider application of the requirements that apply to audits of financial statements of listed entities to all audits of financial statements.</li> </ul>	X	X	X	X	X	X
<ul style="list-style-type: none"> <li>Observations about implementation challenges.</li> </ul>		X	X	X	X	X
<ul style="list-style-type: none"> <li>Feedback on guidance issued and whether additional guidance or material should be developed to support implementation.</li> </ul>				X	X	X



Approach	Investors <sup>21</sup>	Regulators and other oversight authorities <sup>22</sup>	Preparers and TCWG <sup>23</sup>	NSS	Large Firms <sup>24</sup>	Small Firms <sup>25</sup>
<b>ISA 720 (Revised)</b>						
<ul style="list-style-type: none"> <li>Views about the usefulness of the other information section of the auditor's report and whether this has improved the communicative value of and transparency about the audit</li> </ul>	X	X	X			
<ul style="list-style-type: none"> <li>Implementation challenges with respect to ISA 720 (Revised) drawing specific attention to the matters in Appendix C.</li> </ul>			X	X	X	X
<ul style="list-style-type: none"> <li>Actions taken to address implementation challenges.</li> </ul>				X	X	X

*This document contains preliminary views and/or AUASB Technical Group recommendations to be considered at a meeting of the AUASB, and does not necessarily reflect the final decisions of the AUASB. No responsibility is taken for the results of actions or omissions to act on the basis of reliance on any information contained in this document (including any attachments), or for any errors or omissions in it.*



# AUASB Board Meeting Summary Paper

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**AGENDA ITEM NO.**        **3.0**  
**Meeting Date:**            12 June 2019  
**Subject:**                    Quality Management Exposure Drafts  
**Date Prepared:**            21 May 2019

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**Action Required**

**For Information Purposes Only**

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## **Agenda Item Objectives**

1. To update the AUASB on the key themes / messages coming out of the Sydney, Melbourne, Brisbane and LNN roundtables.
2. To obtain AUASB feedback/input into questions raised on Exposure Drafts ISQM 1, ISQM 2 and ISA 220; with particular reference to the Australian specific questions (refer attached Explanatory Memorandums). Feedback will be used by the Technical Group in preparing the draft submission to be brought to the 26 June 2019 AUASB teleconference for approval.

## **Background**

1. The IAASB has 3 Exposure drafts (ISQM 1, ISQM 2 and ISA 220) on issue with a comment period ending 1 July 2019.
2. The AUASB has exposed the IAASB's Exposure Drafts along with the IAASB questions on Exposure. Additionally, the AUASB has included Australian specific questions on each Exposure Draft. The AUASB comment period closes 5 June 2019.
3. The AUASB has held outreach roundtables in Sydney, Melbourne and Brisbane as well as with the Large National Network firms. Feedback from these sessions, will be used to inform the AUASB submission to the IAASB.

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*This document contains preliminary views and/or AUASB Technical Group recommendations to be considered at a meeting of the AUASB, and does not necessarily reflect the final decisions of the AUASB. No responsibility is taken for the results of actions or omissions to act on the basis of reliance on any information contained in this document (including any attachments), or for any errors or omissions in it.*

## **Matters to Consider**

### ***Part A – General***

1. The AUASB is requested to provide input into the questions raised on exposure of the quality management standards, with particular reference to the Australian specific questions (refer attached Explanatory Memorandums). The ATG will use the AUASB input as well as input received from stakeholders at the various outreach sessions, in preparing the draft submission to be brought to the 26 June 2019 AUASB teleconference for approval.

## **Material Presented**

Agenda Item 3.0	AUASB Board Meeting Summary Paper
Agenda Item 3.1	Explanatory Memorandum ISQM 1
Agenda Item 3.2	Explanatory Memorandum ISQM 2
Agenda Item 3.3	Explanatory Memorandum ISA 220

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## **Action Required**

<b>No.</b>	<b>Action Item</b>	<b>Deliverable</b>	<b>Responsibility</b>	<b>Due Date</b>	<b>Status</b>
1.			AUASB	12 June 2019	

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# **Explanatory Memorandum**

## ***ISQM 1 Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements***

Issued by the **Auditing and Assurance Standards Board**



**Australian Government**

**Auditing and Assurance Standards Board**



## Obtaining a Copy of this Explanatory Memorandum

This Explanatory Memorandum is available on the Auditing and Assurance Standards Board (AUASB) website: [www.auasb.gov.au](http://www.auasb.gov.au)

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## **EXPLANATORY MEMORANDUM**

### ***ISQM 1 Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements***

#### **Introduction**

1. The International Auditing and Assurance Standards Board (IAASB) has issued for public comment three exposure drafts (EDs) on interrelated proposed auditing standards that address quality management at the engagement and firm level. This explanatory memorandum represents the Australian exposure of one of those standards, Proposed International Standard on Quality Management ISQM 1 *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements* (ED – ISQM 1).
2. This Explanatory Memorandum is to be read in conjunction with the overarching Explanatory Guide *Exposure of the IAASB’s Proposed Quality Management Standards in Australia*. The Explanatory Guide provides stakeholders with an overview of the approach to exposing the proposed international quality management standards in Australia.

#### **Overview**

3. This Explanatory Memorandum gives Australian stakeholders an overview of:
  - a) Request for comments – IAASB questions and additional Australian questions;
  - b) Background to the matters identified for further consideration by the AUASB during the review of the proposed international standard;
  - c) How to provide comments and the Australian comment date; and
  - d) Planned outreach in Australia to gather further feedback on the proposed standards.
4. ED – ISQM 1 includes the IAASB’s Explanatory Memorandum (EM) and is provided as an attachment to this Australian Explanatory Memorandum. Importantly, the IAASB’s EM presents an overview of “Significant Matters” in relation to ED – ISQM 1 which outlines to stakeholders the main changes from the existing ISQC 1 including:
  - a) A new proactive risk-based approach to firms’ systems of quality management;
  - b) Modernising the standard for an evolving and increasingly complex environment, including addressing the impact of technology, networks, and use of external service providers;
  - c) Increasing firm leadership responsibilities and accountability, and improving firm governance; and
  - d) More rigorous monitoring of quality management systems and remediation of deficiencies.

#### **Request for Comments**

5. The AUASB requests comments on all matters in relation to ED - ISQM 1, but specifically in relation to the questions below, which comprise both IAASB and Australian specific questions. Stakeholders’ responses to IAASB and Australian specific questions will be used to inform the AUASB in their formal response to the IAASB on ED - ISQM 1. Additionally, responses will be used in future deliberations supporting the issuance of the Australian standard. Stakeholders may address only specific questions relevant to them or raise other matters not specifically addressed by a question.

## **IAASB Questions**

*NB: There are no variations between the questions below and those in the IAASB's Explanatory Memorandum, but for completeness and ease of use by respondents they are replicated in the Australian Explanatory Memorandum for ED – ISQM 1.*

### **Overall Questions**

1. Does ED – ISQM 1 substantively enhance firms' management of engagement quality, and at the same time improve the scalability of the standard? In particular:
  - (a) Do you support the new quality management approach? If not, what specific attributes of this approach do you not support and why?
  - (b) In your view, will the proposals generate benefits for engagement quality as intended, including supporting the appropriate exercise of professional scepticism at the engagement level? If not, what further actions should the IAASB take to improve the standard?
  - (c) Are the requirements and application material of proposed ED – ISQM 1 scalable such that they can be applied by firms of varying size, complexity and circumstances? If not, what further actions should the IAASB take to improve the scalability of the standard?
2. Are there any aspects of the standard that may create challenges for implementation? If so, are there particular enhancements to the standard or support materials that would assist in addressing these challenges?
3. Is the application material in ED – ISQM 1 helpful in supporting a consistent understanding of the requirements? Are there areas where additional examples or explanations would be helpful or where the application material could be reduced?

### **Specific Questions**

4. Do you support the eight components and the structure of ED – ISQM 1?
5. Do you support the objective of the standard, which includes the objective of the system of quality management? Furthermore, do you agree with how the standard explains the firm's role relating to the public interest and is it clear how achieving the objective of the standard relates to the firm's public interest role?
6. Do you believe that application of a risk assessment process will drive firms to establish appropriate quality objectives, quality risks and responses, such that the objective of the standard is achieved? In particular:
  - (a) Do you agree that the firm's risk assessment process should be applied to the other components of the system of quality management?
  - (b) Do you support the approach for establishing quality objectives? In particular:
    - (i) Are the required quality objectives appropriate?
    - (ii) Is it clear that the firm is expected to establish additional quality objectives beyond those required by the standard in certain circumstances?
  - (c) Do you support the process for the identification and assessment of quality risks?
  - (d) Do you support the approach that requires the firm to design and implement responses to address the assessed quality risks? In particular:
    - (i) Do you believe that this approach will result in a firm designing and implementing responses that are tailored to and appropriately address the assessed quality risks?
    - (ii) Is it clear that in all circumstances the firm is expected to design and implement responses in addition to those required by the standard?

7. Do the revisions to the standard appropriately address firm governance and the responsibilities of firm leadership? If not, what further enhancements are needed?
8. With respect to matters regarding relevant ethical requirements:
  - (a) Should ED – ISQM 1 require firms to assign responsibility for relevant ethical requirements to an individual in the firm? If so, should the firm also be required to assign responsibility for compliance with independence requirements to an individual?
  - (b) Does the standard appropriately address the responsibilities of the firm regarding the independence of other firms or persons within the network?
9. Has ED – ISQM 1 been appropriately modernised to address the use of technology by firms in the system of quality management?
10. Do the requirements for communication with external parties promote the exchange of valuable and insightful information about the firm’s system of quality management with the firm’s stakeholders? In particular, will the proposals encourage firms to communicate, via a transparency report or otherwise, when it is appropriate to do so?
11. Do you agree with the proposals addressing the scope of engagements that should be subject to an engagement quality review? In your view, will the requirements result in the proper identification of engagements to be subject to an engagement quality review?
12. In your view, will the proposals for monitoring and remediation improve the robustness of firms’ monitoring and remediation? In particular:
  - (a) Will the proposals improve firms’ monitoring of the system of quality management as a whole and promote more proactive and effective monitoring activities, including encouraging the development of innovative monitoring techniques?
  - (b) Do you agree with the IAASB’s conclusion to retain the requirement for the inspection of completed engagements for each engagement partner on a cyclical basis, with enhancements to improve the flexibility of the requirement and the focus on other types of reviews?
  - (c) Is the framework for evaluating findings and identifying deficiencies clear and do you support the definition of deficiencies?
  - (d) Do you agree with the new requirement for the firm to investigate the root cause of deficiencies? In particular:
    - (iii) Is the nature, timing and extent of the procedures to investigate the root cause sufficiently flexible?
    - (iv) Is the manner in which ED – ISQM 1 addresses positive findings, including addressing the root cause of positive findings, appropriate?
    - (v) Are there any challenges that may arise in fulfilling the requirement for the individual assigned ultimate responsibility and accountability for the system of quality management to evaluate at least annually whether the system of quality management provides reasonable assurance that the objectives of the system have been achieved?
13. Do you support the proposals addressing networks? Will the proposals appropriately address the issue of firms placing undue reliance on network requirements or network services?
14. Do you support the proposals addressing service providers?
15. With respect to national standard setters and regulators, will the change in title to “ISQM” create significant difficulties in adopting the standard at a jurisdictional level?

### **Australian Specific Questions**

#### *Matters for further consideration in relation to the Quality Management Standards*

Stakeholders are asked to respond to the following specific questions included to reflect matters identified by the AUASB during its deliberations on the IAASB's development of the Quality Management Standards. Further information about the matters related to each of the questions can be found in table 1 below.

16. Do you consider the definition of engagement teams has been consistently applied across the suite of Quality Management Standards? (Refer to **Matter 7** in table 1)
17. In relation to engagement quality reviews (Refer to **Matter 9** in table 1):
  - (a) Do you agree with the definition of Engagement Quality Reviews/Reviewer and do you consider the term to be clear and capable of application in a consistent way across engagements?
  - (b) Do you agree that engagement quality reviews should also be performed for audits of financial statements of entities that the firm determines are significant public interest entities?
  - (c) Is the term "significant public interest entity" clear and capable of application in a consistent way across engagements in Australia?

#### *Matters for further consideration in relation to ED – ISQM 1*

Stakeholders are asked to respond to the following specific questions identified by the AUASB during its deliberations on the IAASB's development of ED – ISQM 1. Further information about the matters related to each of the questions can be found in Table 1 below.

18. Do you consider the requirements of ED – ISQM 1 are drafted appropriately to result in a principles-based standard? If no, what elements within the requirements are not principles-based? (Refer to **Matter 3** in table 1)
19. Do you consider that components of the System of Quality Management (SOQM) should be weighted / proportionate within the standard, that is, to have greater or lesser focus to assist in meeting the overall objective of audit quality? How would you demonstrate proportionality of the components of SOQM? (Refer to **Matter 2** in table 1)
20. Are the introductory paragraphs and appendix necessary and do you find them helpful; or do you find the introductory paragraphs and appendix to be duplicative and the content addressed elsewhere within the requirements and application material? (Refer to **Matter 4** in table 1)
21. Are the requirements and application material contained within paragraphs 10(c), 29 and A57 sufficiently clear? Is it clear what items may fall into this category and how you will demonstrate compliance? (Refer to **Matter 5** in table 1)
22. Do you support the documentation requirements in paragraph 67, particularly those related to the monitoring and remediation process? Do you consider that the documentation requirements in relation to the monitoring and remediation process are proportionate relative to the remainder of the documentation requirements for other elements of the system of quality management? If yes, provide your reasons; if no, provide your reasons and suggestions. (Refer to **Matter 6** in table 1)
23. Do you consider that the term service provider is clearly articulated in paragraph 64 and is capable of application in a consistent way across engagements? Do you agree with the examples of resources provided by a service provider as contained in paragraph A205 of the proposed standard? (Refer to **Matter 8** in table 1)

**Explanatory Memorandum: ISQM 1 Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements**

*Considerations related to Australian Principles and Practices and Laws and Regulation*

Stakeholders are asked to respond to the following AUASB specific questions which reflect considerations for ED – ISQM 1 related to the Australian regulatory environment and principles and practices considered appropriate in Australia.

*NB: The AUASB is yet to consider Australian modifications to this standard as part of its due process. Refer to paragraph 7 for further information.*

24. Are there any modifications to the extant ASQC 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Historical Financial Information, Other Assurance Engagements and Related Services Engagements* which are still relevant to ED – ISQM 1? Refer to Appendix 1 for summary of extant Australian modifications.
25. Have applicable laws and regulations been appropriately addressed in the proposed standard? Are there any references to relevant laws or regulations that have been omitted?
26. Whether there are any laws or regulations that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?
27. Whether there are any principles and practices considered appropriate in maintaining or improving audit quality in Australia that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?
28. What, if any, are the additional significant costs to/benefits for auditors and the business community arising from compliance with the requirements of this proposed standard? If significant costs are expected, the AUASB would like to understand:
  - (i) Where those costs are likely to occur;
  - (ii) The estimated extent of costs, in percentage terms (relative to audit fees); and
  - (iii) Whether expected costs outweigh the benefits to the users of audit services?
29. Are there any other significant public interest matters that stakeholders wish to raise?

**Matters identified for further consideration by the AUASB**

6. As part of its International Strategy, the AUASB reviews the ongoing progress of all IAASB proposed standards over the course of their development. The AUASB’s International Strategy is designed to ensure the AUASB influences international standards and guidance as early as possible, by identifying matters for consideration that achieve public interest outcomes and ensuring they serve as the most effective base for the Australian auditing and assurance standards.

Matters 1-9 in Table 1 below have been raised by the AUASB during this review process and resulted in additional questions 16-23 in the ‘Request for Comments’ above or are the subject of an existing IAASB question.

**Table 1 – Matters Identified by the AUASB**

<b>Matter #</b>	<b>Para</b>	<b>Matter Raised</b>	<b>Brief Description</b>
1	Overall	Improvement to audit quality	The AUASB raises for consideration whether there is a clear demonstration of the linkage of the original objectives to revise ISQC 1 and how the proposed revisions to ISQM 1 will result in improved audit quality. The AUASB considers that a prescriptive approach to each component of the System of Quality Management (SOQM) may be detrimental to audit quality.  The IAASB has raised a question in this regard – refer question 1(c) and 5.

**Explanatory Memorandum: ISQM 1 Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements**

Matter #	Para	Matter Raised	Brief Description
2	Overall	Scalability	<p>The AUASB raises for consideration whether the prescriptive approach to each component of the SOQM may be detrimental to audit quality, and there is a lack of weighting and proportionality to each requirement. Additionally, we consider a critical element of a system of quality control is flexibility to circumstances and risk environments. This prescriptive approach may be less scalable than the current principles in extant ISQC 1 and may increase compliance costs and time at the firm level without necessarily achieving improved audit quality.</p> <p>Also, the AUASB notes that there is language used within the standard that may be a barrier to scalability. For example, the AUASB raises concern with the application material in paragraph A55: <i>‘There is a reasonable possibility of a quality risk occurring when the likelihood of its occurrence is more than remote’</i>.</p> <p>The AUASB has included a specific question in the Explanatory Memorandum, refer question 19.</p> <p>Additionally, the IAASB has raised a question in this regard – refer question 1(c).</p>
3	Overall	Principles versus Prescriptiveness	<p>IAASB standards are meant to be principles-based and, as such, the Quality Control Task Force’s intended approach is for firms to apply professional judgement to the quality objectives, risks and associated responses for each component. The AUASB raises for consideration whether the current drafting of ED - ISQM 1 is too prescriptive. The AUASB notes the objectives embedded in each component of the SOQM to be compliance based with a very prescriptive approach to each component of the SOQM.</p> <p>The AUASB has included a specific question in the Explanatory Memorandum, refer question 18.</p> <p>Additionally, the IAASB has raised questions in this regard - refer questions 4 and 6.</p>
4	Introductory paragraphs and appendix	Repetition	<p>The AUASB raises for consideration that the introductory paragraphs and appendix are largely repetitive of the requirements and application material, albeit in a summary form. The AUASB notes that some of the content may be best suited to a ‘best practice’ guide and not contained in the standard itself.</p> <p>The AUASB has included a specific question in the Explanatory Memorandum, refer question 20.</p> <p>Additionally, the IAASB has raised a question in this regard - refer question 3.</p>
5	Overall	Legally enforceable standards	<p>The AUASB raises for consideration how compliance with this standard can be demonstrated particularly in jurisdictions where standards are legally enforceable. The AUASB highlights in particular paragraphs 10(c), 29 and A57 that require the firm to determine whether it is appropriate to establish quality objectives beyond those required by the standard in order to achieve the objectives of the standard.</p> <p>The AUASB has included a specific question in the Explanatory Memorandum, refer question 21.</p>



**Explanatory Memorandum: ISQM 1 Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements**

<b>Matter #</b>	<b>Para</b>	<b>Matter Raised</b>	<b>Brief Description</b>
			Additionally, the IAASB has raised questions in this regard - refer questions 6(b)(ii) and 6(d)(ii).
6	Documentation	Proportionality	The AUASB raises for consideration whether the documentation requirements of paragraph 67(c) may be overly granular and disproportionately weighted to monitoring and remediation.  The AUASB has included a specific question in the Explanatory Memorandum, refer question 22.
7	19(f)	Ambiguity of definitions across the QM suite in relation to Engagement Team	The AUASB raises for consideration the definition of the term <b>Engagement Team</b> used across the suite of Quality Management Standards. The AUASB notes that the definitions are not used/defined consistently across the standards, are not clear and accordingly may not be capable of application in a consistent way, for example EQCR, experts, specialists, group component auditors.  The AUASB has included a specific question in the Explanatory Memorandum, refer question 16.
8	64, A205-A207	Service Provider	The AUASB raises for consideration whether the term <b>Service Provider</b> as contained within paragraph 64 of the proposed standard is clear enough and raises concerns as to the examples of resources provided by service providers presented under paragraph A205. For example, the AUASB notes that the examples of IT software providers and external experts may not be appropriate examples of service providers.  The AUASB has included a specific question in the Explanatory Memorandum, refer question 23.
9	19, 37(e)	EQCR	The AUASB notes that the scope of engagements subject to EQCR now includes audits of financial statements of entities that the firm determines are significant public interest entities.  The AUASB has included a specific question in the Explanatory Memorandum, refer question 17.

**Consideration of Australian modifications from the extant ASQC 1**

7. As outlined in the Explanatory Guide *Exposure of the IAASB's Proposed Quality Management Standards in Australia*, at this stage of the exposure process the AUASB has not considered Australian modifications to the proposed standard to reflect Australian principles and practices and laws and regulations. This will be completed at a later date once the proposed international standard is finalised.
8. To guide the AUASB in the future deliberation of Australian modifications to the proposed international standard, Australian stakeholders are asked to consider whether any current Australian specific modifications contained in the extant version of ASQC 1<sup>1</sup> are applicable to the proposed revised ISQM 1. The list of modifications in the extant ASQC 1 is summarised in Appendix 1. Refer to Question 24.

**Comment Date**

9. Comments to the AUASB will close on Wednesday 5 June 2019. This allows for the AUASB Audit Technical Group to analyse stakeholder comments and prepare a draft submission to the

<sup>1</sup> Auditing Standard ASQC 1 Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Financial Information, Other Assurance Engagements and Related Services Engagements

IAASB. The AUASB will then deliberate the content of the draft submission at a 26 June 2019 teleconference. The AUASB submission is due to the IAASB on 1 July 2019.

10. Where stakeholders for timing or other reasons cannot share a written submission with the AUASB, we request that feedback be provided in another form. Where stakeholders are intending to only share feedback directly with the IAASB, we request that:
  - (a) the AUASB is kept informed of any major concerns with the exposure drafts and if possible that the stakeholder submits or at least shares their submissions to the IAASB with the AUASB as early as possible, which may be on a confidential basis; and
  - (b) stakeholders respond directly to the AUASB on the Australian specific questions.

### **Planned Outreach in Australia**

11. The AUASB plans to hold roundtable events in Sydney, Melbourne, Brisbane and Perth. Additionally, the AUASB intends to collaborate closely with the NZAuASB and the professional bodies in their outreach plans; so that we obtain sufficient feedback from the SMP sector. The AUASB is seeking involvement from practitioners who provide services other than audit, as the revised Quality Management Standards impacts those practitioners as well. Furthermore, the AUASB expects to host webinars summarising feedback from roundtable sessions, with a view to seeking additional feedback on specific areas. The timing of outreach events will be finalised by the end of March 2019 and posted on the AUASB website.

## Appendix 1:

### Extracts of Australian Amendments from ASQC 1:

Extant ASQC 1 Paragraph number	Australian text
Aus 1.1	This Auditing Standard, ASQC 1 (the Standard), deals with the firm’s responsibilities for its system of quality control for audits and reviews of financial reports and other financial information, other assurance engagements and related services engagements. This Standard is to be read in conjunction with relevant ethical requirements. Relevant ethical requirements are defined in ASA 102.*
Aus 4.1	This Standard applies to all firms of assurance practitioners in respect of audits and reviews of financial reports and other financial information, other assurance engagements and related services engagements. The nature and extent of the policies and procedures developed by an individual firm to comply with this Standard will depend on various factors such as the size and operating characteristics of the firm, and whether it is part of a network.
Aus 4.2	The requirements of this Standard apply to a firm, not to the individual auditor(s) within the firm.
Aus 12.1	Assurance engagement means an engagement in which an assurance practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users, other than the responsible party, about the outcome of the evaluation or measurement of a subject matter against criteria.
Aus 12.2	Assurance practitioner means an individual, firm, or other organisation, whether in public practice, industry and commerce, or the public sector conducting assurance engagements, or related services engagements (including engagements to perform agreed-upon procedures).
Aus 12.3	Date of report means the date the assurance practitioner signs the report.
Aus 12.4	Engagement documentation means the record of work performed, relevant evidence obtained, and conclusions the assurance practitioner reached (terms such as “working papers” or “workpapers” are sometimes used).
Aus 12.5	Engagement partner means the partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body. Engagement partner should be read as referring to a public sector equivalent where relevant.
Aus 12.6	Engagement team means all partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform procedures on the engagement. This excludes an auditor’s external expert engaged by the firm or by a network firm.
Aus 12.7	Firm means a sole practitioner, partnership or corporation or other entity of assurance practitioners. Firm should be read as referring to a public sector equivalent where relevant.
Aus 12.8	Limited assurance engagement means an assurance engagement where the assurance practitioner’s objective is a reduction in assurance engagement risk to a level that is acceptable in the circumstances of the assurance engagement, but where that risk is greater than that for a reasonable assurance engagement, as the basis for a negative form of expression of the assurance practitioner’s conclusion. A limited assurance engagement is commonly referred to as a review.
Aus 12.9	Other financial information means historical financial information and information other than historical financial information (for example, prospective financial information).

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\* See ASA 102 *Compliance with Ethical Requirements when Performing Audits, Reviews and Other Assurance Engagements*.

**Explanatory Memorandum: ISQM 1 Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements**

Extant ASQC 1 Paragraph number	Australian text
Aus 12.10	Partner means any individual with authority to bind the firm with respect to the performance of an audit, review, other assurance engagement or related services engagement. Partner should be read as referring to a public sector equivalent where relevant.
Aus 12.11	<p>AUASB Standards means standards issued by the AUASB, comprising:</p> <p>(a) Australian Auditing Standards, which means the suite of auditing standards issued by the AUASB, comprising:</p> <ul style="list-style-type: none"> <li>• Auditing Standards made under section 336 of the <i>Corporations Act 2001</i>;</li> <li>• <i>ASA 805 Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement</i>; and</li> <li>• <i>ASA 810 Engagements to Report on Summary Financial Statements</i>.</li> </ul> <p>(b) Standards on Review Engagements;</p> <p>(c) Standards on Assurance Engagements; and</p> <p>(d) Standards on Related Services.</p>
Aus 12.12	Relevant ethical requirements means relevant ethical requirements as defined in ASA 102.
Aus 12.13	<p>Suitably qualified external person means an individual outside the firm with the competence and capabilities to act as an engagement partner. For example:</p> <ul style="list-style-type: none"> <li>• a partner of another firm, or</li> <li>• a member (with appropriate experience) of a professional accountancy body* whose members may perform audits and reviews of financial reports and other financial information, other assurance engagements or related services engagements, or</li> <li>• a member (with appropriate experience) of an organisation that provides relevant quality control services.</li> </ul>
Aus 24.1	At least annually, the firm shall obtain written confirmation of compliance with its policies and procedures on independence from all firm personnel required to be independent by relevant ethical requirements, and applicable legal and regulatory requirements. (Ref: Para. A10-A11)
Aus 34.1	The reasons alternative courses of action from consultations were undertaken, are documented. (Ref: Para. A36 A40)
Aus A1.1	For assurance engagements conducted in the public sector by Auditors General pursuant to legislation, public sector auditors should have regard to the relevant public sector mandate and address any threats in that context. Requirements relating to independence (paragraphs 21 25), acceptance and continuance of client relationships and specific engagements (paragraphs 26 28), and complaints and allegations (paragraphs 55 56) may not be consistent with the Auditors General legislative mandate in all circumstances.
Aus A7.1	The firm is required to comply with relevant ethical requirements, including those pertaining to independence, when performing audits and reviews, other assurance engagements and related services engagements, as defined in ASA 102.
	[Deleted by the AUASB. Refer ASA 102]
	[Deleted by the AUASB. Refer ASA 102]
Aus A10.1	<p>Independence (Ref: Para. 21)</p> <p>Examples of independence requirements that may be applicable are addressed in the <i>Corporations Act 2001</i> Part 2M.3 Division 3, and relevant ethical requirements.*</p>

\* For example, Chartered Accountants Australia and New Zealand, CPA Australia and the Institute of Public Accountants.

**Explanatory Memorandum: ISQM 1 Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements**

Extant ASQC 1 Paragraph number	Australian text
Aus A12.1	A familiarity threat may be created by using the same senior personnel on an assurance engagement over a long period of time.
Aus A13.1	<p>Determining appropriate criteria to address familiarity threats may include matters such as:</p> <ul style="list-style-type: none"> <li>• The nature of the engagement, including the extent to which it involves a matter of public interest; and</li> <li>• The length of service of the senior personnel on the engagement.</li> </ul> <p>Examples of safeguards that might be appropriate to address familiarity threats include rotating the senior personnel or requiring an engagement quality control review.</p>
Aus A14.1	A familiarity threat is particularly relevant in the context of financial report audits of listed entities. For these audits, relevant ethical requirements and the <i>Corporations Act 2001</i> specify partner rotation requirements.
Aus A22.1	For example, the firm may be required to obtain consent from the Australian Securities and Investments Commission (ASIC) prior to resigning from certain audits.
Aus A61.1	<p>For audits or reviews of financial reports conducted under the <i>Corporations Act 2001</i> (the Act), section 307B of that Act requires an auditor or member of an audit firm to retain all audit working papers prepared by or for, or considered or used by, the auditor in accordance with the requirements of the Australian Auditing Standards until:</p> <ol style="list-style-type: none"> <li>(a) The end of seven years after the date of the audit report prepared in relation to the audit or review to which the audit working papers relate; or</li> <li>(b) An earlier date determined by the Australian Securities and Investments Commission for the audit working papers.</li> </ol>
Aus A61.2	Relevant law or regulation, other than the <i>Corporations Act 2001</i> , may require the retention of audit working papers for specified periods.
Aus A63.1	Unless otherwise specified by law or regulation, engagement documentation remains the property of the firm. The firm may, at its discretion, make portions of, or extracts from, engagement documentation available to clients, provided such disclosure does not undermine the validity of the work performed or the independence of the firm or its personnel.
Aus A68.1	In the public sector, an auditor appointed under statute (for example, an Auditor General) may delegate responsibility for an engagement. The monitoring process needs to include, on a cyclical basis, inspection of at least one completed engagement of each person with delegated responsibility for an engagement and its performance. This includes an external person engaged as the person responsible for an engagement.

# ATTACHMENT 1 – PROPOSED INTERNATIONAL STANDARD ON QUALITY MANAGEMENT ISQM 1

**Exposure Draft**  
**February 2019**  
*Comments due: July 1, 2019*

*International Standard on Quality Management*

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**Proposed International Standard  
on Quality Management 1  
(Previously International  
Standard on Quality Control 1)**

*Quality Management for Firms  
that Perform Audits or Reviews  
of Financial Statements, or  
Other Assurance or Related  
Services Engagements*

**IAASB**

**International Auditing  
and Assurance  
Standards Board**

## About the IAASB

This Exposure Draft was developed and approved by the International Auditing and Assurance Standards Board (IAASB).

The objective of the IAASB is to serve the public interest by setting high-quality auditing, assurance, and other related standards and by facilitating the convergence of international and national auditing and assurance standards, thereby enhancing the quality and consistency of practice throughout the world and strengthening public confidence in the global auditing and assurance profession.

The IAASB develops auditing and assurance standards and guidance for use by all professional accountants under a shared standard-setting process involving the Public Interest Oversight Board, which oversees the activities of the IAASB, and the IAASB Consultative Advisory Group, which provides public interest input into the development of the standards and guidance. The structures and processes that support the operations of the IAASB are facilitated by the International Federation of Accountants (IFAC).

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ISA.





## REQUEST FOR COMMENTS

This Exposure Draft, proposed ISQM 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*, was developed and approved by the International Auditing and Assurance Standards Board® (IAASB®).

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by July 1, 2019.**

Respondents are asked to submit their comments electronically through the IAASB website, using the "[Submit a Comment](#)" link. Please submit comments in both a PDF and Word file. First-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website.

This publication may be downloaded from the IAASB website: [www.iaasb.org](http://www.iaasb.org). The approved text is published in the English language.

# EXPLANATORY MEMORANDUM

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## Section 1 Introduction

1. This memorandum provides background to, and an explanation of, the Exposure Draft of proposed International Standard on Quality Management 1 (Previously International Standard on Quality Control (ISQC) 1<sup>1</sup>), *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements* (ED-ISQM 1), which the IAASB approved for exposure in December 2018. The sections that follow describe the key issues considered by the IAASB in developing ED-ISQM 1. The proposed revisions address the most relevant public interest issues related to firms' systems of quality control, including those highlighted in the Invitation to Comment (ITC) released in December 2015, [Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits](#).
2. ED-ISQM 1 is part of a package of proposed quality management standards on which the IAASB is seeking public comment. This memorandum supplements the overall explanatory memorandum, [The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level](#). The overall explanatory memorandum includes background to the IAASB's three quality management Exposure Drafts, discusses the scalability of the standards and sets forth the IAASB's considerations regarding the possible effective dates of the three standards following final approval by the IAASB and approval of due process by the Public Interest Oversight Board. The overall explanatory memorandum also explains the linkages between the three quality management standards and addresses the related conforming amendments to the IAASB's International Standards on Auditing (ISAs).

## Section 2 Guide for Respondents

The IAASB welcomes comments on all matters addressed in ED-ISQM 1, but especially those identified in the Request for Comments section. Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and make specific suggestions for any proposed changes to wording. Respondents are free to address only questions relevant to them. When a respondent agrees with the proposals in ED-ISQM 1, it will be helpful for the IAASB to be made aware of this view as support for the IAASB's proposals cannot always be inferred when not explicitly stated.

## Section 3 Significant Matters

### Section 3A – A New Approach Focused on Quality Management

3. An effective system of quality control provides the foundation for the approach to achieving consistent engagement quality, as it sets out what is needed in a firm's system of quality control to manage the quality of engagements performed by the firm. Extant ISQC 1 requires firms to establish and maintain a system of quality control and specifies the policies and procedures that firms are required to establish as part of the system of quality control.
4. In the wake of the financial crisis, many companies responded to the changing environment and emerging corporate governance risks by revisiting their business practices and relevant activities. Questions have arisen about whether extant ISQC 1 remains fit for purpose, given the evolving environment in which firms operate, the intensifying focus on quality and the increasing expectations of firms' stakeholders. Furthermore, the findings from the post-implementation review of the clarified

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

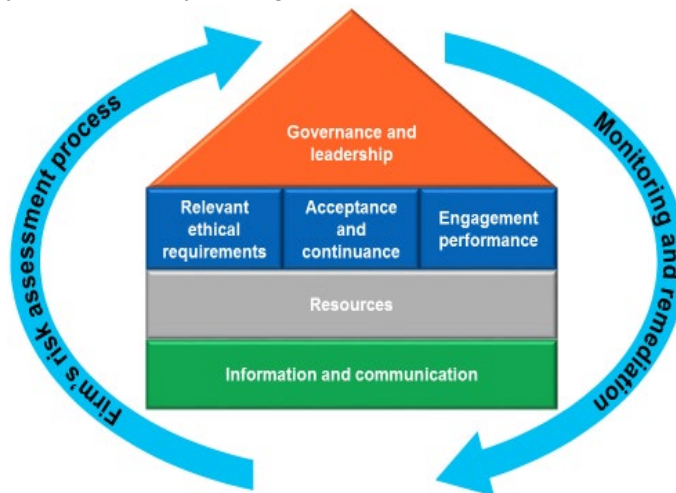
ISAs, inspection findings and ongoing outreach have suggested that several aspects of extant ISQC 1 could be more robust, and that additional action is needed to address the proportional application of the standard by small- and medium-sized practitioners (SMPs).

5. Recognizing these issues, the ITC highlighted several public interest issues, which included the need for proactive management of quality and keeping the standard fit for purpose. The ITC suggested that a new approach to quality control at the firm level is needed that emphasizes the responsibility of firm leadership for proactively managing quality, while at the same time being scalable to deal with differences in the size of firms and nature of the services they provide. As a result, the ITC proposed a new approach for ISQC 1, the quality management approach.
6. Respondents to the ITC supported the quality management approach because it is more risk-based and proactive, and agreed that the approach could provide benefits for firms' systems of quality control, including that it would likely enhance the ability for firms to proportionately apply the standard. However, some respondents noted that only limited information had been provided in the ITC about the new approach and cautioned that the new approach should not simply result in add-ons to the existing requirements that may result in compliance with the standard becoming unnecessarily onerous, particularly for SMPs. On the other hand, other respondents were concerned that a new approach could diminish the robustness of ISQC 1 because the approach would involve more judgment and some of the requirements of the extant standard may not be adapted to the risk-based approach appropriately.
7. The IAASB concluded that in order to substantively enhance firms' management of engagement quality and at the same time improve the scalability of the standard, ED-ISQM 1 should incorporate the new quality management approach that would be focused on proactively identifying and responding to risks to quality. This approach would include other enhancements to address key issues highlighted in the ITC to improve the robustness of firms' systems of quality management (e.g., enhanced requirements and focus on governance and leadership, monitoring and remediation, and circumstances when a firm belongs to a network).
8. The essence of the new approach is to focus firms' attention on risks that may have an impact on engagement quality. Unlike extant ISQC 1, the new approach requires a firm to customize the design, implementation and operation of its system of quality management based on the nature and circumstances of the firm and the engagements it performs. The new approach also requires the firm to transition from policies and procedures that address standalone elements, as required by extant ISQC 1, to an integrated approach that reflects upon the system as a whole.
9. The new approach, termed quality management, is expected to generate multiple benefits for firms' systems of quality management that support the consistent performance of quality engagements, including:

The new quality management approach aims to improve the scalability of ED-ISQM 1 because it requires a firm to **customize** the design, implementation and operation of its system of quality management based on the **nature and circumstances of the firm and the engagements it performs**

- (a) A system that is tailored for the nature and circumstances of the firm and the engagements it performs, thereby improving the robustness and effectiveness of activities undertaken by the firm to address engagement quality. A tailored system of quality management may also result in improved utilization of firm resources.
  - (b) Facilitating a proactive response by the firm to changing circumstances and proactively managing or mitigating risks, and promoting continual improvement and responsiveness. This new approach will also aid in keeping the standard fit for purpose and adaptable to a changing environment.
  - (c) Increased emphasis on monitoring the system as a whole and timely and effective remediation, to promote ongoing improvement and consideration of the appropriateness of the system, including whether it is effective in supporting engagement quality.
  - (d) Improved integration of the components of the system, thereby promoting an ongoing process of improvement, and consideration of the effect of decisions across the system.
10. In incorporating the new approach into the standard, the IAASB considered many other risk management and governance frameworks, such as the COSO Integrated Framework (2013).<sup>2</sup> ED-ISQM 1 has many similarities to these frameworks, where the aim is to achieve objectives or principles through managing risks to achieving those objectives. The IAASB also undertook outreach with firms that have begun to adopt risk-based approaches in their systems of quality control.
11. Given the new references to quality management, the title of the standard and other references to quality control in the requirements and application material have been changed to refer to quality management. The IAASB recognizes that many jurisdictions have law or regulation that requires firms to adopt ISQC 1 or otherwise refer to ISQC 1 in jurisdictional professional standards, and changing the title may create the need for law or regulation or jurisdictional standards to be amended. However, the IAASB notes the introduction of ED-ISQM 2, which may also create the need for amendments to law or regulation or jurisdictional standards. The IAASB is seeking views of respondents as to whether the change in title will create significant difficulties in adopting the standard at a jurisdictional level (see question 15).

*The Components of a System of Quality Management*



<sup>2</sup> Committee of Sponsoring Organizations of the Treadway Commission *Internal Control – Integrated Framework (2013)*

12. In determining the key components of the system of quality management that need to be addressed in ED-ISQM 1, the IAASB considered the organization of the other risk management and governance frameworks highlighted previously and how the elements in extant ISQC 1 should be retained. The IAASB agreed that retaining the elements of extant ISQC 1 is important as they reflect topics that continue to be relevant to a firm's system of quality management and provide a necessary link to the management of quality at the engagement level (i.e., ED-220<sup>3</sup>). The eight components of the proposed system of quality management, which are depicted in the diagram, are as follows:
- (a) Governance and leadership (adapted from "leadership responsibilities for quality within the firm" in extant ISQC 1);
  - (b) The firm's risk assessment process (new);
  - (c) Relevant ethical requirements;
  - (d) Acceptance and continuance of client relationships and specific engagements;
  - (e) Engagement performance;
  - (f) Resources (adapted from "human resources" in extant ISQC 1);
  - (g) Information and communication (new); and
  - (h) Monitoring and remediation process (adapted from "monitoring" in extant ISQC 1).
13. While ED-ISQM 1 is organized according to the eight components, firms are not required to organize their systems according to these discrete components (see paragraph A5 of ED-ISQM 1). ED-ISQM 1 only requires that a firm meet all of the requirements of the standard in designing, implementing and operating its system of quality management. For example, provided that all of the requirements of the standard are still met, a firm may have different names for the components, may combine the components or may have additional components.
14. Unlike the elements of extant ISQC 1 that appear disconnected from one another, the eight components in ED-ISQM 1 are specifically designed and described as highly integrated. For example, resources and information and communication are essential aspects that enable the operation of each of the other components of the system of quality management. The integration of the components means that the system of quality management does not operate in a linear manner. As a result, many aspects of ED-ISQM 1 would be designed, implemented and operated by the firm in an iterative manner.
15. In order to provide an overall understanding of the integrated nature of the system, the introductory paragraphs of the standard provide a summary explanation of the components (see paragraphs 8–13 of ED-ISQM 1). Additionally, the interrelationships between the components have been emphasized and explained throughout ED-ISQM 1. However, the IAASB agreed that matters that relate to more than one component should not be repeated in each component because that would result in a voluminous standard and be perceived as more prescriptive. For example, communication of independence matters is not specifically required in the relevant ethical requirements component because it is addressed by the broader requirements in the information and communication component.

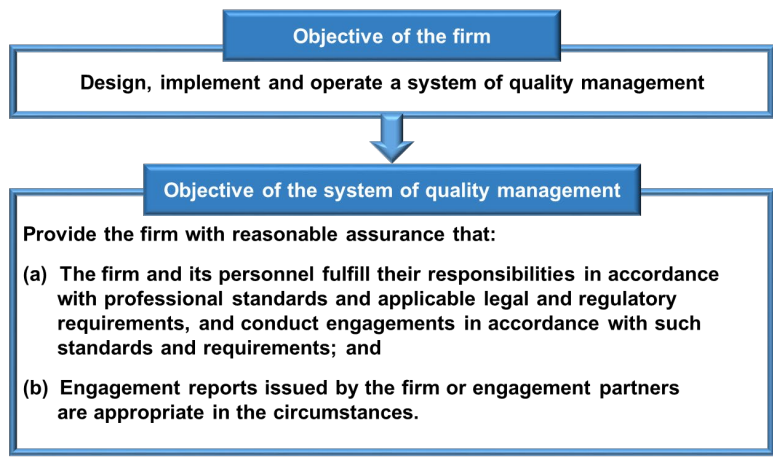
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<sup>3</sup> Proposed International Standard on Auditing (ISA) 220 (Revised), *Quality Management for an Audit of Financial Statements*

**Section 3B – General Considerations**

*Objective of the Standard*

- 16. The *objective of the firm* in the context of the standard is to design, implement and operate a system of quality management.
- 17. The system of quality management is designed to achieve the following two objectives, which are similar to the objectives in extant ISQC 1:
  - (a) The firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements; and
  - (b) Engagement reports issued by the firm or engagement partners are appropriate in the circumstances.
- 18. An effective system of quality management provides the firm with reasonable assurance regarding the achievement of the two objectives (see paragraph A3 of ED-ISQM 1). A system of quality management cannot be designed to provide absolute assurance, because of the inherent limitations of a system, for example, human error or uncertainty in judgments. The term "reasonable assurance" rather than "absolute assurance" acknowledges that limitations exist in all systems of quality management, and that uncertainties and risks may exist that cannot be predicted. Accordingly, the *objective of the system of quality management* is to provide the firm with reasonable assurance regarding the achievement of the objectives. In this context, reasonable assurance is not intended to be obtained through independent assurance that the system is effective (i.e., in the case of an assurance engagement). Instead, reasonable assurance is obtained through the operation of the system as a whole. This approach is similar to other risk management and governance frameworks.



Objective of ED-ISQM 1

*Public Interest*

- 19. In the ITC, one of the actions proposed to address the culture of the firm and responsibility and accountability of leadership for quality was to emphasize in the introduction or application material the importance of relevant public interest considerations in relation to the design of the firm’s system of quality control. Respondents to the ITC had mixed views about this proposal and indicated that there is no common interpretation or understanding of the term “public interest.”
- 20. The International Ethics Standards Board for Accountants (IESBA) *International Code of Ethics for Professional Accountants (including International Independence Standards)* (the Code) indicates that professional accountants have a responsibility to act in the public interest. The IAASB is of the view that although public interest considerations vary across engagement types, the consistent performance of quality engagements is integral to a firm’s responsibility to act in the public interest. As a result, paragraph 23(c) of ED-ISQM 1 describes the firm’s role in serving the public interest, and paragraphs 7 and A2 of the standard explain the meaning of this term and its relationship to the Code.

21. Paragraph 7 of ED-ISQM 1 also explains the connection between the public interest and the objective of the standard. However, some Board members were of the view that the firm's role to act in the public interest should be explicitly referred to in the objective of the standard. Others were of the view that without explicit criteria, a reference to acting in the public interest in the objective would result in an objective that is not capable of being consistently measured, observed or attained. The IAASB is seeking the views of respondents on whether it is clear how achieving the objective of the standard relates to the firm's public interest role (see question 5).

### *Professional Judgment and Professional Skepticism*

#### Professional Skepticism at the Engagement Level

22. One of the most significant public interest issues highlighted in the ITC is fostering an appropriately independent and challenging skeptical mindset of the auditor. The IAASB recognizes that many aspects of the firm's system of quality management support the exercise of professional skepticism at the engagement level. For example:
- (a) The firm's culture and the tone set by leadership should promote the importance of quality, and the need to exercise professional skepticism when performing audit, review or other assurance engagements.
  - (b) Allocating appropriate resources to perform engagements may prevent impediments to professional skepticism, such as limited time, knowledge or experience.

Given the pervasive effect of the system of quality management on supporting professional skepticism at the engagement level, ED-ISQM 1 does not specifically highlight which aspects of the system support professional skepticism. However, an emphasis on professional skepticism at the engagement level has been made in the introductory section and the engagement performance component (see paragraphs 7 and 36(b) of ED-ISQM 1). Furthermore, ED-220 addresses professional skepticism in the context of managing quality at the engagement level through explaining the impediments to the exercise of professional skepticism and actions that the engagement partner may take to deal with such impediments.

#### Professional Judgment and Professional Skepticism at the Firm Level

23. Unlike extant ISQC 1, ED-ISQM 1 explicitly requires the firm to exercise professional judgment in applying the requirements of the standard. Doing so is necessary so that a firm's system of quality management is appropriately tailored to the nature and circumstances of the firm and the engagements it performs. The need to exercise professional judgment is reinforced throughout the standard and a definition of professional judgment has been introduced (see, for example, paragraphs 7, 8, 19(n) and 22 of ED-ISQM 1).
24. The IAASB considered whether the concept of professional skepticism is relevant to professional judgments made about the system, and agreed that professional skepticism is a concept that is relevant to judgments made in performing engagements. Nevertheless, the IESBA's project addressing the [role, mindset and behavioral characteristics expected of all professional accountants when performing their professional activities](#) may be relevant to professional judgments made about the system of quality management, and the IAASB will continue to coordinate with IESBA in considering the impact of that project on ED-ISQM 1.



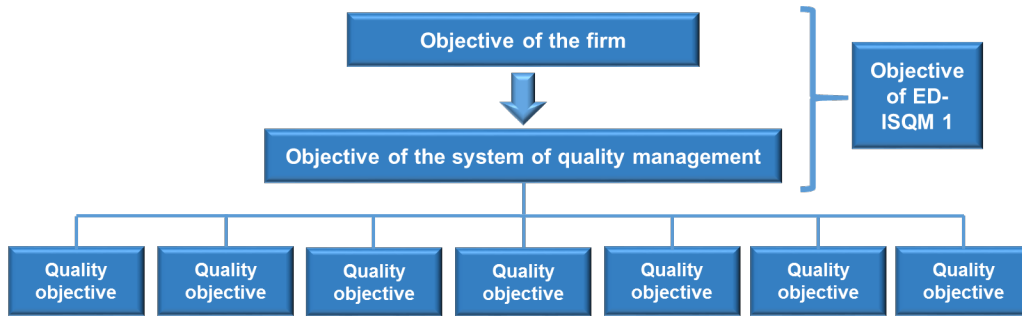
**Section 3C – The Firm’s Risk Assessment Process**

- 25. As explained in Section 3A, ED-ISQM 1 includes a new approach that focuses firms’ attention on risks that may have an impact on engagement quality. ED-ISQM 1 includes a component, the firm’s risk assessment process, which comprises the process the firm is required to follow in implementing the risk-based approach to quality management. The firm’s risk assessment process is applied to the other seven components of the system of quality management, i.e., the firm is required to use this process in establishing quality objectives, identifying and assessing quality risks, and designing and implementing responses for the other seven components.
- 26. As explained previously in this explanatory memorandum, ED-ISQM 1 does not require that firms organize their systems according to the components. Accordingly, firms may perform the firm’s risk assessment process in a variety of ways, for example, the process may be applied to the firm as a whole for all components together, the process may be applied individually to each component, or the process may be applied to individual business units or service lines (see paragraph A48 of ED-ISQM 1).



*Establish Quality Objectives*

- 27. The quality objectives established by the firm consist of objectives that, when achieved by the firm, collectively provide the firm with reasonable assurance that the objectives of the system of quality management are achieved (see paragraph 19(p) of ED-ISQM 1). The relationship between the quality objectives, the objective of the system of quality management and the objective of the standard is as follows:



- 28. ED-ISQM 1 includes quality objectives that all firms are required to establish (see paragraphs 23, 32, 34, 36, 38, 40 and 42 of ED-ISQM 1). The quality objectives are outcome-based and how they are achieved is determined by the firm, thereby improving the scalability of the standard. The quality objectives required by the standard comprise important aspects of extant ISQC 1 that have been retained<sup>4</sup> as well as objectives that have been introduced to address key issues highlighted in the ITC or elements the IAASB considers necessary for a system of quality management.

<sup>4</sup> In developing the quality objectives, the IAASB identified that there was an inconsistent level of granularity across the requirements in extant ISQC 1. As a result, some of the requirements transposed from extant ISQC 1 are less specific in ED-ISQM 1 to ensure a consistent level of granularity across the quality objectives.

29. The IAASB is of the view that the quality objectives in ED-ISQM 1 are comprehensive and, if properly addressed by a firm, will result in the system providing reasonable assurance that its objectives have been achieved. However, the IAASB recognizes that the nature and circumstances of firms and the engagements they perform will vary, which may give rise to the need for the firm to establish additional quality objectives beyond those set out in the standard in order to achieve the objective of the standard. Accordingly, the firm is required to establish additional quality objectives beyond those required by the standard, when those objectives are necessary to achieve the objective of the standard (see paragraph 26 of ED-ISQM 1). This requirement will also aid in keeping the standard fit for purpose and adaptable to a changing environment. A description of the purpose of each component has been included in each lead-in to the requirement to establish quality objectives.<sup>5</sup>



30. The IAASB debated whether there should also be a requirement for firms to establish more granular quality objectives than those required by the standard in order to facilitate the identification and assessment of quality risks, i.e., a requirement for the firm to break down the quality objectives required by the standard into more specific quality objectives. The IAASB agreed that such a requirement would not be necessary, as some firms may identify high-level objectives that may be as effective in providing a basis for the identification and assessment of quality risks as firms that choose to establish more granular quality objectives. Accordingly, establishing more granular quality objectives is not required (see paragraph A49 of ED-ISQM 1).

*Identify and Assess Quality Risks*

31. A risk-based approach supports the firm in focusing its efforts and resources on areas where they are needed the most. ED-ISQM 1 recognizes that it is not reasonable or practicable for firms to identify and assess every possible risk, and to design and implement responses for every risk (see paragraph A54 of ED-ISQM 1). Accordingly, ED-ISQM 1 includes a process for identifying and assessing quality risks that includes a threshold for identifying quality risks and a requirement to assess those risks identified, such that the nature, timing and extent of the responses designed and implemented by the firm are appropriately focused on what is important for the system of quality management. The threshold for identifying quality risks is those risks for which (a) there is a reasonable possibility of the risk occurring; and (b) if the risk were to occur, it may individually or in



<sup>5</sup> For example, paragraph 38 of ED-ISQM 1 describes the resources component as “appropriately obtaining, developing, using, maintaining, allocating and assigning resources, including human resources, technological resources, and intellectual resources, in a timely manner to enable the design, implementation and operation of the system of quality management.”

combination with other quality risks, have a significant effect on the achievement of a quality objective(s).

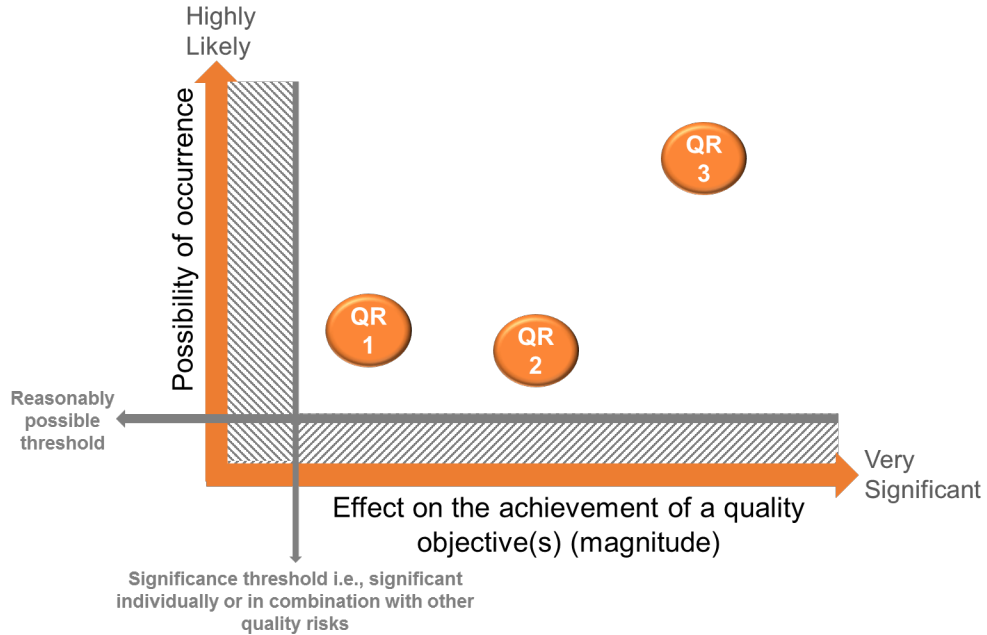
32. The IAASB is of the view that a consistent approach to identifying and assessing risks across the IAASB’s standards helps to reinforce key concepts of a risk-based approach. Accordingly, the approach for identifying and assessing quality risks in ED-ISQM 1 echoes the principles in the IAASB’s recently published Exposure Draft, ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement* (ED-315).<sup>6</sup>
33. The process in ED-ISQM 1 consists of two steps:
  - (a) Identifying the quality risks that meet the threshold described in paragraph 31, based on a preliminary consideration of the possibility of the quality risks occurring and their effect on the achievement of the quality objectives (see paragraph 28 of ED-ISQM 1); and
  - (b) Assessing the identified quality risks, which involves a more detailed consideration of the degree of the likelihood of the quality risks occurring and the significance of the effect of the identified quality risks on the achievement of the quality objectives (see paragraph 29 of ED-ISQM 1). The purpose of assessing the quality risks is to assist the firm in designing and implementing responses, because the reasons for the assessment of the quality risks affect the nature, timing and extent of the responses.

The IAASB acknowledges that in some instances, the two steps may be undertaken concurrently by the firm. However, the firm is not expected to assess every quality risk; the firm is only expected to assess those risks that reach the threshold criteria. The process for identifying quality risks and the further assessment is depicted as follows:



<sup>6</sup> The IAASB plans to consider the feedback from respondents on ED-315 as it relates to the concepts incorporated in ED-ISQM 1, including whether the threshold of “a reasonable possibility of occurring” is appropriate.

34. As explained above, the assessment of the identified quality risks involves a more detailed consideration of the possibility of occurrence and effect on the achievement of a quality objective(s), and may entail an analysis such as the following:



35. Unlike the quality objectives, ED-ISQM 1 does not identify quality risks that are applicable for all firms. The firm is expected to identify and assess its own quality risks for the quality objectives set forth in the standard and any additional quality objectives that the firm has established, taking into account the nature and circumstances of the firm and the engagements it performs. As a result, the quality risks identified and assessed by the firm are customized and tailored for the firm. The IAASB is of the view that specifying quality risks in the standard would result in less tailored quality risks and would likely drive a checklist-based approach to implementing the standard, contrary to the new quality management approach.

*Design and Implement Responses*

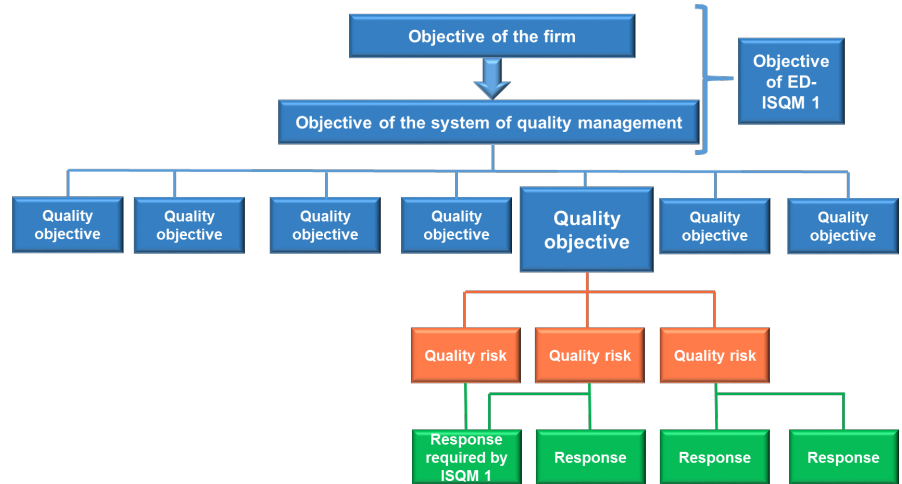
Definition of Responses

36. The definition of controls in ED-315 refers to policies or procedures, consistent with the COSO Integrated Framework (2013).<sup>7</sup> The IAASB is of the view that responses to quality risks are analogous to controls, and therefore the definition of responses in ED-ISQM 1 has been aligned to the definition of controls in ED-315 (see paragraph 19(t) of ED-ISQM 1). This definition recognizes that policies or procedures may include aspects of governance, for example, tone at the top and other aspects of the firm’s system which are established but are not formally documented policies or procedures. The IAASB used the term responses instead of controls or policies or procedures because it emphasizes the importance of responding to the quality risks and the proactive nature of the new quality management approach.

<sup>7</sup> The COSO Integrated Framework (2013) describes control activities as the actions established by policies and procedures to help ensure management directives to mitigate risks to the achievement of objectives are carried out.

The Requirement to Design and Implement Responses

37. ED-ISQM 1 requires the firm to design and implement responses to address the quality risks, in order that the quality objectives are achieved (see paragraph 30 of ED-ISQM 1). As explained previously, the standard includes quality objectives that are comprehensive and, if properly addressed by a firm, will result in the system providing reasonable assurance that its objectives have been achieved. ED-ISQM 1 includes some responses that all firms are required to design and implement, however these responses are not comprehensive (see paragraphs 24, 25, 33, 35, 37, 41 and 43 of ED-ISQM 1). For example, the resources component does not include any required responses. As a result, the standard is explicit that the firm is required to design and implement responses to address the assessed quality risks, in addition to the responses required by the standard (see paragraphs 10(c) and A59 of ED-ISQM 1). In the view of the IAASB, this approach promotes a tailored and scalable approach to managing quality.



38. The responses in ED-ISQM 1 that all firms are required to design and implement include:

- (a) Important aspects of extant ISQC 1 that need to be retained in order to preserve the robustness of the extant standard;
- (b) New matters that have been introduced to address key issues, for example, issues highlighted in the ITC (e.g., undertaking periodic performance evaluations of firm leadership); or
- (c) Responses needed for consistency with, or linkage to, other professional standards, including relevant ethical requirements and ED-220.

Although these responses are required by the standard, the firm would tailor them taking into account the assessed quality risks that the responses address, as well as the nature and circumstances of the firm and the engagements it performs. For example, paragraph 33(d) of ED-ISQM 1 requires the firm to obtain, at least annually, a documented confirmation of compliance with independence requirements from all personnel required by relevant ethical requirements to be independent. The firm may tailor this response by adapting its frequency (e.g., obtaining the confirmation twice a year), or by adding specificity as to how the firm’s personnel will evidence the confirmation (e.g., a manual signature on a hard copy or a digital signature through an IT application).

39. The IAASB explored including more prescriptive responses in the standard, but agreed that doing so would deter firms from identifying and assessing the quality risks in a proper manner and result in firms only implementing the responses required by the standard, contrary to the new quality management approach. Furthermore, the IAASB noted that it would not be possible to comprehensively address all of the responses needed by firms in the standard, given the varying nature and circumstances of firms and the engagements they perform.

*Changes in the Nature and Circumstances of the Firm or its Engagements*

40. A key aspect of the quality management approach is continuous improvement. ED-ISQM 1 sets forth two instances when the quality objectives, quality risks or responses may need to be revised to improve the system:
- (a) As a result of information arising from the firm's monitoring activities. The revisions to the monitoring and remediation component in ED-ISQM 1 have improved the focus on ongoing, or more real-time, monitoring. In responding to identified deficiencies, which may be identified through the firm's own monitoring activities, external inspections or other information sources, paragraph 49 of ED-ISQM 1 requires the firm to determine whether the firm's quality objectives, assessed quality risks and responses remain appropriate, and modify them, as appropriate.
  - (b) As a result of changes in the nature and circumstances of the firm or its engagements. Paragraph 31 of ED-ISQM 1 requires the firm to take actions to identify these changes and modify the quality objectives, quality risks or responses, as appropriate, in response to such changes.

**Section 3D – Governance and Leadership**

41. The ITC noted that extant ISQC 1 does not specifically address firm governance, or contain much detail as to what is expected from firm leadership in relation to firm governance, and therefore included various suggestions to address firm governance and enhance the role of firm leadership in sustaining and continually improving audit quality. Respondents to the ITC overall supported the various suggestions to strengthen firm governance and leadership, although emphasized that any actions would need to be flexible to accommodate different jurisdictions and firm structures.
42. The IAASB is of the view that a firm's governance and leadership is of paramount importance to engagement quality, as it is the way in which the firm embeds its culture and ethics and self-regulates, and serves as the framework for how the firm's decisions are made. Accordingly, the governance and leadership component has been placed first in ED-ISQM 1. A firm's governance also affects the public's perception of the firm; a firm without effective governance may be regarded as one that does not operate in the public interest.
43. In developing the various quality objectives and responses for this component, the IAASB considered numerous global resources addressing governance and leadership in general for all entities, and those more specific to the governance of audit firms. ED-ISQM 1 has been substantially enhanced to improve the robustness of firms' governance and leadership. In particular, it addresses the expected behavior of firm leadership in setting the tone at the top, the appropriate qualifications of leadership, and holding leadership accountable through performance evaluations. The standard also now addresses the effect of the firm's strategic actions, including financial and operational decisions,<sup>8</sup> on engagement quality and the firm's public interest role, as well as firm leadership's ability to influence decisions about the firm's resources.
44. In developing the requirements, the IAASB considered who in the firm should be ultimately responsible for the system of quality management, and whether that responsibility should be extended to quality more broadly. The IAASB resolved to retain the requirement of extant ISQC 1, which assigns this role to the firm's chief executive officer (or equivalent) or, if appropriate, the firm's

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<sup>8</sup> The IAASB is of the view that commercial considerations are the same as financial and operational decisions, and preferred the latter term as it provides a more accurate description of what is meant.

managing board of partners (or equivalent) (see paragraph 24(a) of ED-ISQM 1). However, recognizing that SMPs may not have these types of roles in their leadership structures, outreach feedback suggested that an additional option should be added to acknowledge SMPs (i.e., the firm's managing partner). The IAASB further agreed that leadership cannot be responsible and accountable for quality broadly, but is responsible and accountable for the system of quality management that supports the consistent performance of quality engagements. The accountability of leadership is reinforced by the new requirement for the firm to undertake performance evaluations of those assigned leadership roles.

45. In developing ED-ISQM 1, the IAASB undertook various outreach activities across many stakeholder groups. The IAASB heard concerns that SMPs may experience practical challenges in implementing certain proposals related to governance and leadership. The IAASB is of the view that the requirements in this component are universally applicable to firms of all sizes, in particular since the quality objectives have been established as outcomes. The nature and extent of the actions taken in achieving those objectives may be more simple for an SMP. For example, paragraph A28 of ED-ISQM 1 explains that a smaller firm may be able to establish the desired culture of the firm through the direct interaction of firm leadership with other personnel, which is not always possible in the case of a larger firm. Furthermore, paragraph 21 of the standard recognizes that not all requirements are relevant in all circumstances, and paragraph A20 of ED-ISQM 1 provides examples of when the requirements might not be relevant, which includes aspects of governance and leadership in certain circumstances.

#### Operational Responsibility for Compliance with Independence Requirements

46. In the ITC the IAASB had included a proposal to specifically require a firm to identify appropriate personnel within the firm's leadership to be responsible and accountable for independence matters. This proposal was included in response to calls from certain regulatory stakeholders to the IESBA to more clearly and robustly address the issue of responsibility for independence within a firm. Although respondents to the ITC expressed mixed views about this proposal, the IAASB is of the view that independence is critical to the performance of engagements for which independence is required. Accordingly, requiring firms to assign responsibility for independence emphasizes that independence is an important consideration in a firm's system of quality management (see paragraph 24(a)(iii) of ED-ISQM 1). This new requirement operates in conjunction with many other enhanced requirements of the standard, for example, the firm may need resources to support its activities to determine compliance with independence requirements.
47. In developing ED-ISQM 1, the IAASB coordinated with the IESBA on many matters of mutual interest, including responsibility for independence. Through this engagement, the IESBA suggested that the requirement in ED-ISQM 1 should more broadly capture responsibility for relevant ethical requirements. In general, the IAASB is of the view that doing so would reduce the focus on the importance of independence. However, the IAASB is interested in respondents' views as to whether there should be an individual assigned responsibility for relevant ethical requirements, and if so, whether this should be in addition to assigning responsibility for compliance with independence requirements (see question 8(a)). The IAASB recognizes that an individual within the firm could fulfill both roles, particularly in the case of an SMP.

## Responsibility for Understanding ED-ISQM 1

48. In order to improve leadership's responsibility for the system of quality management, paragraph 20 of ED-ISQM 1 is more explicit about who is responsible for understanding ED-ISQM 1. However, through its outreach in developing the standard, the IAASB heard that while these individuals may have ultimate responsibility for the system, responsibilities for aspects of the system are delegated to other individuals within the firm who support leadership (this is particularly the case in large firms). As a result, the IAASB heard concerns that requiring those with ultimate or operational responsibility for the system to have an in-depth understanding of the standard would be impractical. Accordingly, paragraph 20 of ED-ISQM 1 has been adjusted from extant ISQC 1 and requires these individuals to have an understanding of ED-ISQM 1 that is relevant to their responsibilities.

## Section 3E – Resources

### Technological Resources

49. The IAASB recognizes that firms are increasingly using technology in performing engagements, which may be developed by the firm or obtained from the firm's network or an external service provider. Firms are also increasing their use of technology in facilitating the operation of their systems of quality management, for example, technology may be used to continually monitor the permissibility of financial investments recorded by personnel as part of the firm's independence responses.
50. As part of the modernization of the standard, the IAASB has introduced a new requirement addressing the use of technological resources, both in the performance of engagements and the operation of the system of quality management (see paragraph 38(e) of ED-ISQM 1). The requirement is principles-based because the IAASB is mindful that the types of technologies, and the extent to which they are being used, are continually evolving. It is noted that the application material includes IT-related concepts that have been explained in a manner consistent with ED- 315.<sup>9</sup>

### Intellectual Resources

51. The IAASB noted that intellectual resources are essential to enabling the performance of quality engagements, and are not addressed in extant ISQC 1. For example, in performing an audit of financial statements, engagement teams ordinarily depend on the firm's methodology to perform their work, which is based on professional standards and addresses applicable law or regulation. Accordingly, a new principles-based requirement addressing intellectual resources has been introduced in ED-ISQM 1, designed to be adaptable to the variety of intellectual resources that may be utilized within the firm (see paragraph 38(f) of ED-ISQM 1).

## Section 3F – Information and Communication

52. Extant ISQC 1 does not address the broader need for information and communication across the system and the communication of information with engagement teams, which is essential for the effective operation of the system of quality management and the performance of engagements. It also does not acknowledge the two-way nature of communication. As a result, ED-ISQM 1 includes

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<sup>9</sup> ED-315 includes new material to address how automated tools and techniques are being used in performing audits. ED-315 also includes significant clarifications and enhancements to address the auditor's understanding of an entity's IT environment, and provides greater clarity on IT-related concepts. The IAASB is mindful that the explanations and descriptions in ED-315 need to be principles-based, given that rapid changes in IT and the terms in which it is described could outdate the standard within a short period of time.



a new component, information and communication, which includes requirements for the firm to establish an information system<sup>10</sup> and emphasizes the need for effective two-way communication within the firm, as well as the responsibility of all personnel for communication (see paragraphs 40 and 41 of ED-ISQM 1). The new component also supports the firm in addressing the need for robust communication and interactions during the performance of engagements, a key public interest issue highlighted in the ITC.

53. The IAASB considered whether the requirements in the information and communication component should further specify with whom communication should take place and the type of information that should be obtained, generated and communicated. The IAASB is of the view that specifying the information and communication needs for each component would result in lengthy requirements and could inadvertently omit information or communication needs. Furthermore, such an approach would be prescriptive and contrary to the principles-based nature of the standard. Accordingly, the requirements do not include this specificity and in designing the system of quality management, the firm would need to understand the integration of the components and the information that needs to be obtained, generated or communicated to support the firm in achieving the requirements of each of the components.

#### *Communication with External Parties*

54. The ITC recognized that some firms are increasingly issuing publicly available reports that provide transparency regarding certain elements of the firm and its operations, commonly referred to as transparency reports. Accordingly, the ITC explored various actions for the IAASB to take. Respondents to the ITC were generally supportive of further actions but cautioned that any actions should not stifle developments or innovation related to transparency reporting at a jurisdictional level. However, certain respondents, mostly investors, called for the IAASB to more specifically address transparency reports in the IAASB's standards.
55. Transparency reports are required in many jurisdictions, largely for firms that perform audits of public interest entities or certain listed entities, and are commonly prepared by firms in certain other jurisdictions on a voluntary basis. However, the IAASB observed that there are still many jurisdictions where transparency reporting is not required or common practice, largely because there is a lack of demand from stakeholders in those regions for such information. Furthermore, firms that tend to prepare transparency reports perform audit engagements of public interest entities or listed entities; there is low demand for transparency reporting for smaller firms that do not perform these types of engagements.
56. The IAASB recognizes that firms communicate with external parties in a variety of ways and the communication is continually evolving. For example, firms may provide information on their website or through a publication other than a transparency report or may have a mechanism to engage directly with external parties. The IAASB is of the view that specifically requiring firms to prepare transparency reports may discourage the exchange of valuable and insightful information with external parties through alternative means that may be more appropriate or effective than a transparency report given the circumstances of the firm. The IAASB further noted that other means of communication with external parties are just as relevant and important as transparency reports.

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<sup>10</sup> Paragraphs A137 and A138 of ED-ISQM 1 explain that the information system may include the use of manual or IT elements, and in smaller firms is likely to be less sophisticated than in larger firms and involve a less complex IT environment.

57. Accordingly, the requirements in ED-ISQM 1 for communication with external parties address all forms of communication with external parties and have been developed in a manner that is adaptable to the circumstances of the firm (see paragraph 41(c) of ED-ISQM 1). The requirements aim to promote the exchange of valuable and insightful information about the firm's system of quality management with the firm's stakeholders without stifling innovation or other developments at the jurisdictional level. Although the requirements explicitly recognize transparency reports so that firms are encouraged to consider whether a transparency report is appropriate, the preparation of a transparency report is not required. However, if jurisdictional law, regulation or professional standards require the firm to prepare a transparency report, this is addressed by the requirement in paragraph 41(c)(i) of ED-ISQM 1.

### **Section 3G – Engagement Quality Reviews**

58. An engagement quality review is a firm-level response to an assessed quality risk(s) that is implemented by the engagement quality reviewer on behalf of the firm. As explained in the explanatory memorandum for ED-ISQM 2, the IAASB agreed that since the engagement quality review is a response to an assessed quality risk(s), ED-ISQM 1 should address the engagements for which an engagement quality review is to be performed. The specific criteria for an individual to be eligible to perform the engagement quality review and requirements for the performance and documentation of the review are located in ED-ISQM 2.
59. The ITC proposed several enhancements to address engagement quality reviews, given the need to keep the standard fit for purpose and enhance support for exercising professional skepticism at the engagement level. Among the proposals, the IAASB explored whether the requirements for engagements that should be subject to an engagement quality review should be strengthened by requiring an engagement quality review for audits of entities other than listed entities. The ITC considered whether it would be appropriate to require an engagement quality review to be performed for audits of public interest entities (PIEs), as this term is used in the Code. However, the IAASB recognized in the ITC the difficulty of defining the term on a global basis, given the various definitions and interpretations across different jurisdictions.
60. Respondents to the ITC supported strengthening the requirement; however, there was not extensive support for requiring the performance of an engagement quality review for audits of PIEs. Respondents who did not support this proposal noted that the lack of a universal definition of PIEs could lead to inconsistent application in practice. Further, they noted that in many jurisdictions PIEs could include very small or non-complex entities (such as small charities) and performing an engagement quality review for audits of such entities would be overly burdensome.
61. However, the IAASB recognizes the need to enhance the scope of engagements subject to an engagement quality review, because there are audits of certain entities for which engagement quality reviews would be appropriate. These entities may include, for example, some entities operating in the public sector, and financial institutions such as certain banks, insurance companies and pension funds. Accordingly, paragraph 37(e)(ii) of ED-ISQM 1 includes a new requirement for the firm's policies or procedures to require an engagement quality review for audits of financial statements of entities that the firm determines are of significant public interest. ED-ISQM 1 also provides application material that describes the characteristics of such entities, to support firms in fulfilling this requirement. "Entities that are of significant public interest" is a term that is used elsewhere in the

IAASB's standards, such as ISA 700 (Revised)<sup>11</sup> and ISA 260 (Revised),<sup>12</sup> to describe those entities that may have characteristics that give rise to similar public interest issues as listed entities. Although the IAASB has determined that this term continues to be suitable for its purposes, there may be questions as to how the term relates to "public interest entity" as defined in the Code. If respondents have views on this topic, it would be helpful for these views to be included in their responses to Question 11.

62. The IAASB is of the view that in addition to audits of listed entities or entities that the firm determines are of significant public interest, an engagement quality review may be an appropriate response to an assessed quality risk(s) for other engagements. Accordingly, paragraph 37(e)(iii)(b) of ED-ISQM 1 requires the firm to establish policies or procedures to require an engagement quality review for engagements for which the firm determines that an engagement quality review is an appropriate response, based on the reasons for the assessments given to the assessed quality risk(s). However, the IAASB recognizes that an engagement quality review is not always an appropriate response to an assessed quality risk(s) and paragraph A95 of ED-ISQM 1 explains that other types of responses may be more appropriate or effective to address the assessed quality risk(s).

### Section 3H – Monitoring and Remediation Process

63. The ITC highlighted the need for greater focus on internal and external monitoring and remediation activities as one of the key public interest issues, and an area where the extant standard is in need of modernization. The improvements proposed in the ITC for monitoring and remediation were in general supported by respondents. As a result, ED-ISQM 1 has various new and improved requirements for monitoring and remediation, in particular:
- (a) The requirements promote more proactive and effective monitoring activities and have increased the emphasis on tailoring the monitoring activities to provide a sufficient basis for the firm to evaluate the system. The IAASB is of the view that this approach may encourage firms to develop innovative monitoring techniques to further enhance quality management.
  - (b) The requirements focus on monitoring all aspects of the system. Extant ISQC 1 is largely focused on inspections of completed engagements, which only address monitoring responses that are implemented at the engagement level.
  - (c) The requirements acknowledge that there may be a variety of information sources that provide the firm with information about the operation of the system of quality management, including external inspection findings.
  - (d) The requirements have been clarified to differentiate between findings and deficiencies, so that it is clear that not all findings are deficiencies for which further action is needed.
  - (e) The firm is now required to investigate the root causes of deficiencies so that appropriate action can be taken to remediate the deficiencies effectively.
  - (f) The responsibilities of firm leadership have been enhanced, and include a requirement to determine the effectiveness of remedial actions, and an evaluation, at least annually, of whether there is reasonable assurance that the objective of the system has been achieved.

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<sup>11</sup> ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*. See also paragraphs 54–61 of the [Basis for Conclusions to Reporting on Audited Financial Statements](#).

<sup>12</sup> ISA 260 (Revised), *Communication with Those Charged with Governance*

64. While the monitoring and remediation process has been set up in ED-ISQM 1 in a logical order, the IAASB is of the view that the monitoring and remediation process is iterative, as opposed to being purely linear. For example, the firm may adjust the nature, timing or extent of the monitoring activities based on the severity and pervasiveness of the deficiencies identified.

*Monitoring Activities, Including Inspection of Engagements*

65. The IAASB recognizes that the nature, timing and extent of the firm's monitoring activities should vary from firm to firm. Accordingly, the new requirements have been designed to emphasize factors that the firm would consider in designing its monitoring activities, rather than prescribing all of the monitoring activities that need to be performed (see paragraph 44 of ED-ISQM 1).
66. The IAASB debated the retention of the requirement in extant ISQC 1 for the firm to inspect at least one completed engagement for each engagement partner on a cyclical basis. The IAASB noted the need to retain the robustness of the extant standard in this regard but at the same time address concerns that the extant requirement is inflexible and consumes resources that could be used to perform more effective monitoring activities. The IAASB resolved to retain the requirement (see paragraph 45 of ED-ISQM 1), but has taken the following steps to improve its scalability and place emphasis on other types of monitoring activities that may be more effective:
- (a) The requirement explicitly recognizes inspections of in-progress engagements (these may also be referred to as in-process reviews). It is noted that in some cases, in-process reviews may be a monitoring activity, but in other cases they may be a response to a quality risk in another component (e.g., a quality risk related to judgments made in the performance of engagements). Whether an in-process review is a monitoring activity depends on how the firm has designed the review, including how the results of the review are considered and addressed by the firm.
  - (b) The requirement emphasizes that in determining the nature, timing and extent of the inspection of engagements, the firm takes into account various factors set out in the standard, such as changes in the system.
  - (c) Although the firm is still required to inspect one completed engagement per engagement partner on a cyclical basis, more emphasis has been given to the fact that the firm determines the length of the cycle. The application material provides examples of factors that the firm may consider in determining the length of the cycle, which includes the extent to which the firm performs other monitoring activities (e.g., inspections of in-process engagements) and the nature and circumstances of the engagements. The application material also acknowledges that the cycle may vary across engagement partners, for example, the cycle may be more frequent for engagement partners who perform audits of financial statements of listed entities.

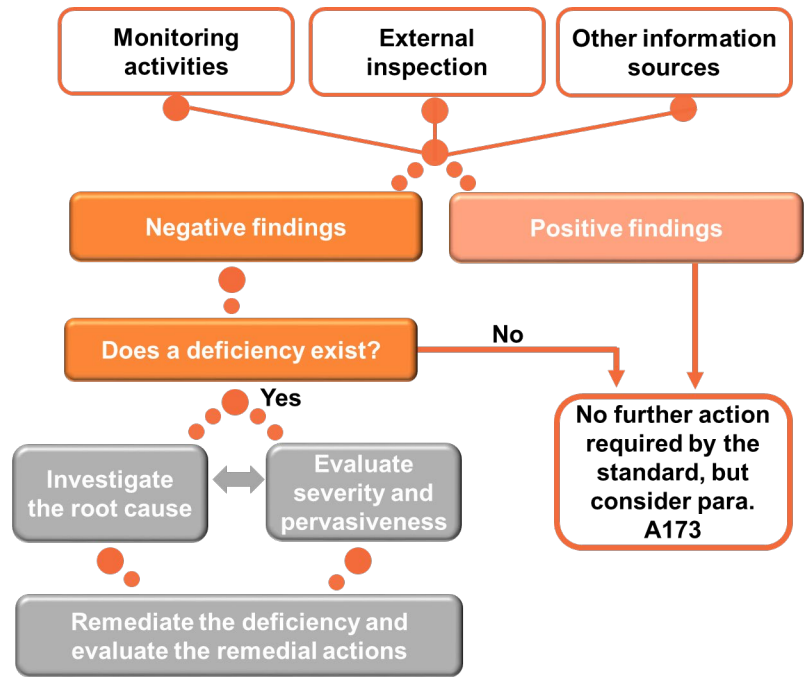
*Monitoring the Monitoring and Remediation Process*

67. The monitoring and remediation process needs to be designed appropriately and operating effectively, because without an effective monitoring and remediation process, the firm would not be able to determine whether deficiencies exist and remediate them. The IAASB is of the view that monitoring of the monitoring and remediation component may be accomplished in a variety of ways including through understanding external information (e.g., the results of external inspections may highlight deficiencies not detected by the firm's monitoring activities) or in undertaking the root cause analysis (e.g., the investigation of a deficiency may reveal further deficiencies not detected by the firm's monitoring activities) (see paragraph A177 of ED-ISQM 1). Paragraph 47 of ED-ISQM 1 requires the firm to identify deficiencies through evaluating the findings arising from monitoring

activities, results of external inspections, and other information. The identification of deficiencies may include deficiencies in the monitoring and remediation process.

*Evaluating Findings and Identifying Deficiencies*

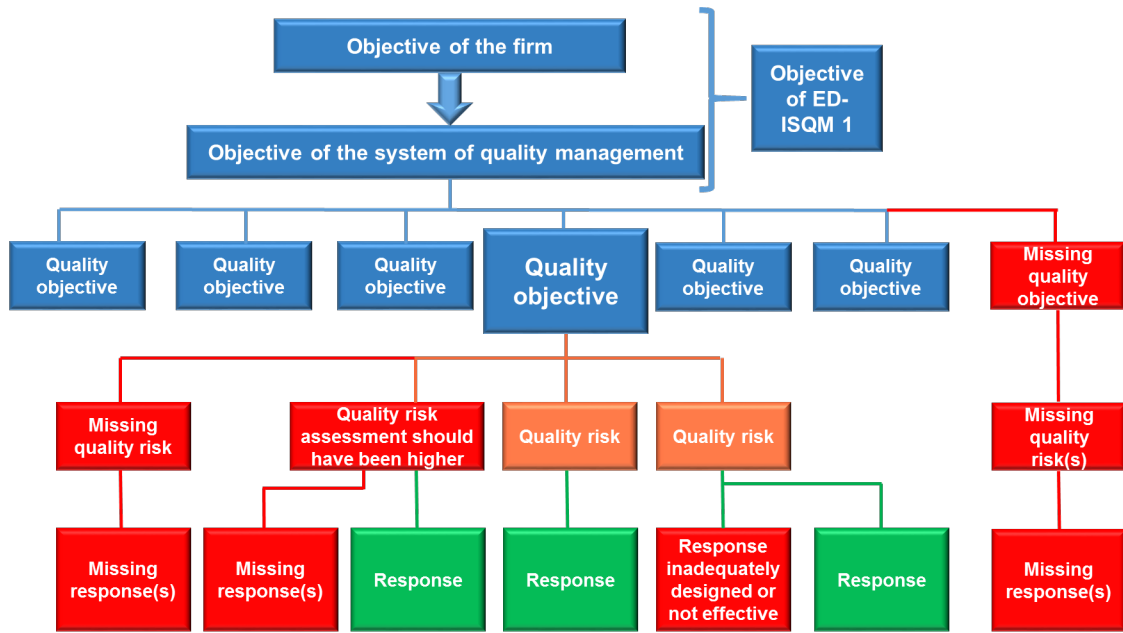
68. Findings may be positive or negative in nature, and the severity and pervasiveness of negative findings will vary. The IAASB is of the view that findings that do not rise to the level of a deficiency do not need to be subject to additional actions, such as investigating the root cause of the finding or remediating the finding. As a result, the IAASB identified the need for a clear definition of a deficiency in ED-ISQM 1<sup>13</sup> (see paragraph 19(a) of ED-ISQM 1) and a supporting framework that sets out the process for evaluating negative findings and identifying deficiencies (see paragraphs 47–48 of ED-ISQM 1). The illustration sets out the framework in ED-ISQM 1, and the application material in ED-ISQM 1 provides further guidance to support the firm in working through the framework.



69. The definition of deficiencies was developed taking into consideration how other standards and frameworks, such as ISA 265<sup>14</sup> and the COSO Integrated Framework (2013), describe deficiencies. The diagram that follows depicts examples of deficiencies that may arise in the firm’s system of quality management in red. This includes circumstances when a response that is necessary to address a quality risk has not been appropriately designed or implemented because the quality objective or quality risk was missing, or the quality risk was not appropriately assessed.

<sup>13</sup> Extant ISQC 1 requires the firm to take certain actions for deficiencies noted in the system of quality control. The term deficiencies is not defined in extant ISQC 1.

<sup>14</sup> ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*



*Root Cause Analysis*

70. Recognizing the increased demand from regulators and audit oversight bodies for firms to take action to understand the causal factors of inspection findings as a means of improving audit quality, the ITC proposed introducing a new requirement for firms to obtain an understanding of the causal factors of audit deficiencies identified by inspections and other reviews. Respondents in general supported this proposal, and therefore ED-ISQM 1 includes a new requirement for firms to investigate the root cause of deficiencies (see paragraph 48(a) of ED-ISQM 1).
71. In developing the new requirement, the IAASB debated the threshold of matters on which the root cause analysis should be performed, including whether the root cause analysis would be undertaken before determining whether a finding is a deficiency. The IAASB is of the view that determining the root cause of every finding would be onerous and consume important resources that should focus on more significant issues in the system of quality management. Therefore, the IAASB concluded that firms should be expected to determine the root cause only of identified deficiencies. However, the IAASB recognizes that in some cases the process may be iterative, i.e., in order to determine whether a finding is a deficiency, the firm may need to have some understanding of the root cause of the finding.
72. ED-ISQM 1 acknowledges that the nature and extent of the firm’s process to determine the root cause of a deficiency would vary depending on the nature and possible severity of the deficiency. For example, the causes of some deficiencies may be more obvious and immediately identifiable, whereas other deficiencies may need a more rigorous process to understand the underlying causes. In ED-ISQM 1, the requirement to determine the severity and pervasiveness of the deficiency follows the requirement to investigate the root cause of the deficiency, however investigating the root cause of the deficiency and determining the severity and pervasiveness of the deficiency is likely to be iterative.
73. The IAASB concurred with views expressed by some respondents to the ITC that determining the root cause of positive findings is valuable because it may reveal opportunities for the firm to improve the system of quality management and may assist the firm in determining the root causes of

deficiencies and how to remediate such deficiencies. Despite these benefits, the IAASB in general is of the view that ED-ISQM 1 should not require firms to determine the root cause of positive findings because the priority is for firms to remediate deficiencies, such that the objective of the standard is achieved. Furthermore, the nature of the positive findings that may enhance the system of quality management would vary and it would therefore be difficult to establish criteria in the standard for determining positive findings that should be subject to root cause analysis. The application material of ED-ISQM 1 discusses the benefits of investigating the root cause of positive findings to encourage firms to include this as part of their policies or procedures addressing the evaluation of the findings (see paragraph A178 of ED-ISQM 1). Nevertheless, the IAASB is interested in the views of respondents regarding how firms currently deal with positive findings and whether this should be more explicitly addressed in the requirements of the standard, or otherwise be more prominently highlighted (see question 12(d)(ii)).

### *Leadership Evaluation of the System of Quality Management*

74. As explained previously, various enhancements have been made to ED-ISQM 1 to enhance the role of firm leadership as it relates to the system of quality management. Paragraph 55 of ED-ISQM 1 is a new requirement for the individual(s) assigned ultimate responsibility and accountability for the system of quality management to evaluate whether the system of quality management provides the firm with reasonable assurance that the objectives of the system have been achieved. In circumstances when it is determined that the system does not provide reasonable assurance that the objectives have been achieved, leadership is responsible for taking appropriate action. The IAASB is of the view that the new requirements reinforce the responsibility and accountability of leadership for the system of quality management. Furthermore, the requirement implicitly creates the need for the firm to collate all of the information about the system of quality management, and for leadership to evaluate this information in forming an overall view about the system.
75. The IAASB envisages that the evaluation would involve a determination of whether the system provides reasonable assurance that the objectives are achieved at the point in time the evaluation is undertaken. The IAASB debated how often the evaluation should be undertaken and agreed that undertaking the evaluation of the system at least annually would be appropriate (see paragraph 56 of ED-ISQM 1), given the requirement in extant ISQC 1 to communicate the results of the monitoring at least annually. However, the IAASB noted that in some instances the evaluation may need to be undertaken more frequently, particularly in circumstances when there is an indication that the system is not effective.

## **Section 3I – Networks and Service Providers**

### *Networks*

76. The IAASB is of the view that in circumstances when networks share common elements related to the system of quality management (e.g., a common methodology or policies or procedures), such common elements can be instrumental in enhancing engagement quality across the firms that belong to the network. For example, in circumstances when a firm is subject to common policies or procedures established by the network, the network may hold the firm accountable for

#### **What is a network?**

Some firms operate internationally through a consortium of network firms, referred to as “a network.” Each firm that forms part of the consortium is referred to as “a network firm.”

The extent to which the network firms share common elements varies. For example, some networks may only share a brand name, while

complying with such policies or procedures. A network may also fulfill functions that the firm would otherwise have to perform, for example, the development of a methodology in accordance with international standards.

77. However, as highlighted in the ITC, concerns have been raised that firms place undue reliance on network requirements or network services (e.g., methodologies, policies or procedures, IT applications or monitoring). Accordingly, new requirements have been introduced in ED-ISQM 1 addressing network requirements or network services (see paragraphs 58–63 of ED-ISQM 1). The aim of the new requirements is to improve the robustness of the firm’s responsibilities for the network requirements or network services, so that the firm understands the network requirements or network services and the effect they have on the firm’s system of quality management. Given the varying structure of networks and the nature of the network requirements or network services, the new requirements are principles-based so that they can be adapted to a variety of circumstances. The IAASB is of the view that the new requirements emphasize that the firm is responsible for its own system of quality management, thereby addressing the issue that firms may place undue reliance on network requirements or network services.
78. The IAASB is of the view that although the new requirements are focused on the firm, they are likely to have an effect on the network. The requirements are structured such that the network would likely need to provide information to all network firms so that the firms are able to fulfill their responsibilities under ED-ISQM 1. This is expected to improve the communication and transparency between the network and network

other networks may share common methodologies or policies or procedures. In some circumstances, the network firms may be monitored by the network for compliance with the methodology or policies or procedures. The network functions (i.e., developing and maintaining the methodology or performing monitoring) may be undertaken by a standalone body established by the network to perform the various network functions.

The structure of the network may also vary. For example, within a network there may be a consortium of network firms that form a cluster within a region. Such clusters may share common policies or procedures specific to that region or there may be services used across the cluster (e.g., training).

The network firms are responsible for the engagements they perform and the reports that are issued on behalf of the network firm, i.e., the network does not perform engagements or issue engagement reports. A firm’s responsibility is established in the IAASB’s Standards,<sup>15</sup> and may be further reinforced by a jurisdictional, professional, legal or regulatory body that specifies who has the appropriate authority to perform an engagement and issue the related report.

The network itself is not responsible for the engagements undertaken by network firms or the reports issued by network firms. Furthermore, as the network is a consortium of network firms, it is not usually regulated or subject to inspection at the network level. The individual firms within the network will most likely be regulated and inspected by the regulators and audit oversight bodies within their jurisdictions or who have

<sup>15</sup> The ISAs apply to “the auditor” or “engagement partner.” ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, defines the auditor as “the person or persons conducting the audit, usually the engagement partner or other members of the engagement team, or, as applicable, the firm.” ISQC 1 defines the engagement partner as “the partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.” ISQC 1 also defines the firm as “a sole practitioner, partnership or corporation or other entity of professional accountants.”



firms, and it may encourage improvements in communication across the network.

oversight of the engagements performed by the firm.

79. In developing ED-ISQM 1, the IAASB considered establishing requirements for the network instead of, or in addition to, the new requirements for the firm. The IAASB notes that the firm is responsible for the engagements it performs and the reports that are issued on behalf of the firm, and regulatory oversight occurs at the level of the firm. The network does not perform engagements and is generally not subject to regulatory inspections or overseen by oversight authorities.<sup>16</sup> Therefore, the IAASB is of the view that the firm needs to remain solely responsible for the system of quality management, i.e., requirements for networks may have the unintended effect of diluting the firm's responsibility for the system of quality management.
80. The IAASB recognizes that some stakeholders do not have an accurate understanding of the responsibilities of the network and network firms, including the relationship between networks and the network firms, and this has given rise to expectation gaps. As a result, ED-ISQM 1 includes application material to encourage firms to provide transparency about their relationships with the network and the responsibilities of the firm and the network in order to enhance stakeholders' understanding of these relationships and responsibilities (see paragraph A152 of ED-ISQM 1).

#### Network Firm Independence

81. In the IAASB's coordination with the IESBA, the IESBA questioned whether there should be more direct requirements in ED-ISQM 1 regarding compliance with independence requirements within the network. The IAASB is of the view that network firm independence is appropriately addressed in ED-ISQM 1 through the principles-based requirements addressing relevant ethical requirements.<sup>17</sup> Therefore, including more direct requirements for independence within the network would result in duplicative requirements, and the specificity of the requirement would be in contrast to other requirements in the standard. However, the IAASB is interested in respondents' views as to whether there should be more specific requirements addressing independence within the network (see question 8(b)).

#### Service Providers

82. Firms may use service providers in the system of quality management, for example, engagement software may be obtained from a service provider or the firm may use a service provider to perform engagement quality reviews. The IAASB is of the view that a service provider provides a resource, and therefore the firm needs to determine that it is appropriate to use that resource in the system of quality management. Accordingly, ED-ISQM 1 includes new requirements addressing the use of service providers in the firm's system of quality management (see paragraphs 64–65 of ED-ISQM 1). The IAASB is of the view that although the new requirements are a responsibility of the firm, they are

<sup>16</sup> Regulators are a critical element in the financial reporting supply chain and the requirements of professional standards are most effective if they are properly enforced through the legal status of standards, inspection of engagements, the investigation of allegations of failure, and when appropriate, disciplinary action being taken.

<sup>17</sup> For example, paragraph 33(a) of ED-ISQM 1 requires the firm to identify the relevant ethical requirements and determine the applicability of the relevant ethical requirements to the firm, its personnel and others, including, as applicable, the network, personnel in the network or other network firms, or service providers (this is further supported by application material that provides examples specific to networks). The firm is further required by paragraphs 33(b) and 33(c) to establish policies or procedures to address threats to compliance with relevant ethical requirements and breaches of the relevant ethical requirements, which would need to address other firms or persons within the network when there are relevant ethical requirements applicable to them.

likely to have an effect on service providers, given the need for service providers to provide information to firms to enable the fulfillment of the new requirements.

83. The IAASB noted that in some cases, a service provider may be obtained through the firm's network, for example, the network may mandate that engagement software has to be acquired from a specific service provider. In such cases, the requirements for service providers would apply to the use of those resources.

### **Section 3J – Other**

84. Many other enhancements have been made to ED-ISQM 1 that although not explicitly highlighted in this memorandum, are also intended to enhance the robustness of the standard. For example, the documentation requirements of the standard have been enhanced from extant ISQC 1, with the introduction of an overarching principles-based requirement (which has similarities to the documentation principles established in ISA 230<sup>18</sup>) and more specific requirements for matters that firms are expected to document.

### **Section 3J – Scalability**

85. The scalability of ED-ISQM 1 has been at the forefront of the IAASB's deliberations throughout the project. The ITC highlighted the need for a new approach to managing quality that is scalable to deal with differences in the size and nature of firms or the services they provide. As discussed previously, the new quality management approach drives firms to think about the nature and circumstances of the firm and the engagements it performs in designing, implementing and operating its system of quality management, and the approach is focused on achieving quality objectives that are outcome-based. While this approach is expected to generate multiple benefits for engagement quality, one of the most important benefits is a tailored system of quality management that is suitable for the nature and circumstances of the firm and the engagements it performs.
86. The IAASB recognizes that the quality management approach in ED-ISQM 1 is more complex than the approach in extant ISQC 1, and has added to the overall length of the standard. However, the IAASB is of the view that the approach in extant ISQC 1 is no longer fit for purpose and adaptable to the changing environment, given that it is more prescriptive in nature, and does not promote a scalable and tailored system of quality management that focuses on areas of risk. The IAASB acknowledges that firms will need to invest time and resources to implement the revised standard initially, however it is of the view that over time a more tailored and focused system of quality management will result in more effective use of firm resources and improvements in engagement quality.
87. Adding to the length of the standard are various new requirements that have been introduced to enhance the rigor of the standard, in particular to address key issues highlighted in the ITC (e.g., governance and leadership, monitoring and remediation, and network requirements or network services) and essential elements needed for a system of quality management (e.g., information and communication). The IAASB acknowledges that the new requirements increase the responsibilities of firms, however they address important issues that are necessary for improvements in engagement quality.

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<sup>18</sup> ISA 230, *Audit Documentation*

88. While the new quality management approach is the fundamental change introduced in the standard to address scalability, the IAASB has addressed or emphasized the scalability of ED-ISQM 1 in other ways, including:
- (a) An explicit discussion about the scalability of the standard in paragraphs 5 and 6 of ED-ISQM 1.
  - (b) A requirement to exercise professional judgment in paragraph 22 of ED-ISQM 1 and increased emphasis on professional judgment throughout the standard.
  - (c) Numerous references throughout the standard to consider the nature and circumstances of the firm and the engagements it performs.
  - (d) An explicit requirement in paragraph 21 of ED-ISQM 1 that indicates that there may be circumstances when a requirement is not relevant to the firm because of the nature and circumstances of the firm or its engagements.
  - (e) Application material that provides examples for SMPs, for example, paragraphs A28 and A42 of ED-ISQM 1.
89. The IAASB debated whether to retain the sections in extant ISQC 1 titled "Considerations Specific to Smaller Firms." However, the IAASB is of the view that given the integrated nature of the standard, an understanding of the entire standard is needed to facilitate the implementation of a system of quality management that is tailored to the circumstances of the firm. As highlighted above, where considered useful and appropriate, the IAASB has included examples specific for SMPs. In addition, the IAASB is developing support materials to show how the standards can be applied in a scalable manner by smaller firms.

*Application Material in ED-ISQM 1*

90. Throughout the development of ED-ISQM 1, the IAASB has heard mixed views through its outreach about examples and explanations in the standard. While examples and explanations provide useful information to support implementation of the standard, they add extensive content that has resulted in an increase in the length of the standard. The IAASB is interested in respondents' views as to the usefulness of the application material in ED-ISQM 1, in particular areas where the examples or explanations are not useful, and areas where additional examples or explanations would be helpful.

## Section 4 Request for Comments

Respondents are asked to comment on the clarity, understandability and practicality of application of the requirements and related application material of ED-ISQM 1. In this regard, comments will be most helpful if they are identified with specific aspects of ED-ISQM 1 and include the reasons for any concern about clarity, understandability and practicality of application, along with suggestions for improvement.

### Overall Questions

- 1) Does ED-ISQM 1 substantively enhance firms' management of engagement quality, and at the same time improve the scalability of the standard? In particular:
  - (a) Do you support the new quality management approach? If not, what specific attributes of this approach do you not support and why?
  - (b) In your view, will the proposals generate benefits for engagement quality as intended, including supporting the appropriate exercise of professional skepticism at the engagement level? If not, what further actions should the IAASB take to improve the standard?
  - (c) Are the requirements and application material of proposed ED-ISQM 1 scalable such that they can be applied by firms of varying size, complexity and circumstances? If not, what further actions should the IAASB take to improve the scalability of the standard?
- 2) Are there any aspects of the standard that may create challenges for implementation? If so, are there particular enhancements to the standard or support materials that would assist in addressing these challenges?
- 3) Is the application material in ED-ISQM 1 helpful in supporting a consistent understanding of the requirements? Are there areas where additional examples or explanations would be helpful or where the application material could be reduced?

### Specific Questions

- 4) Do you support the eight components and the structure of ED-ISQM 1?
- 5) Do you support the objective of the standard, which includes the objective of the system of quality management? Furthermore, do you agree with how the standard explains the firm's role relating to the public interest and is it clear how achieving the objective of the standard relates to the firm's public interest role?
- 6) Do you believe that application of a risk assessment process will drive firms to establish appropriate quality objectives, quality risks and responses, such that the objective of the standard is achieved? In particular:
  - (a) Do you agree that the firm's risk assessment process should be applied to the other components of the system of quality management?
  - (b) Do you support the approach for establishing quality objectives? In particular:
    - i. Are the required quality objectives appropriate?
    - ii. Is it clear that the firm is expected to establish additional quality objectives beyond those required by the standard in certain circumstances?
  - (c) Do you support the process for the identification and assessment of quality risks?

- (d) Do you support the approach that requires the firm to design and implement responses to address the assessed quality risks? In particular:
  - i. Do you believe that this approach will result in a firm designing and implementing responses that are tailored to and appropriately address the assessed quality risks?
  - ii. Is it clear that in all circumstances the firm is expected to design and implement responses in addition to those required by the standard?
- 7) Do the revisions to the standard appropriately address firm governance and the responsibilities of firm leadership? If not, what further enhancements are needed?
- 8) With respect to matters regarding relevant ethical requirements:
  - (a) Should ED-ISQM 1 require firms to assign responsibility for relevant ethical requirements to an individual in the firm? If so, should the firm also be required to assign responsibility for compliance with independence requirements to an individual?
  - (b) Does the standard appropriately address the responsibilities of the firm regarding the independence of other firms or persons within the network?
- 9) Has ED-ISQM 1 been appropriately modernized to address the use of technology by firms in the system of quality management?
- 10) Do the requirements for communication with external parties promote the exchange of valuable and insightful information about the firm's system of quality management with the firm's stakeholders? In particular, will the proposals encourage firms to communicate, via a transparency report or otherwise, when it is appropriate to do so?
- 11) Do you agree with the proposals addressing the scope of engagements that should be subject to an engagement quality review? In your view, will the requirements result in the proper identification of engagements to be subject to an engagement quality review?
- 12) In your view, will the proposals for monitoring and remediation improve the robustness of firms' monitoring and remediation? In particular:
  - (a) Will the proposals improve firms' monitoring of the system of quality management as a whole and promote more proactive and effective monitoring activities, including encouraging the development of innovative monitoring techniques?
  - (b) Do you agree with the IAASB's conclusion to retain the requirement for the inspection of completed engagements for each engagement partner on a cyclical basis, with enhancements to improve the flexibility of the requirement and the focus on other types of reviews?
  - (c) Is the framework for evaluating findings and identifying deficiencies clear and do you support the definition of deficiencies?
  - (d) Do you agree with the new requirement for the firm to investigate the root cause of deficiencies? In particular:
    - i. Is the nature, timing and extent of the procedures to investigate the root cause sufficiently flexible?
    - ii. Is the manner in which ED-ISQM 1 addresses positive findings, including addressing the root cause of positive findings, appropriate?

- (e) Are there any challenges that may arise in fulfilling the requirement for the individual assigned ultimate responsibility and accountability for the system of quality management to evaluate at least annually whether the system of quality management provides reasonable assurance that the objectives of the system have been achieved?
- 13) Do you support the proposals addressing networks? Will the proposals appropriately address the issue of firms placing undue reliance on network requirements or network services?
- 14) Do you support the proposals addressing service providers?
- 15) With respect to national standard setters and regulators, will the change in title to “ISQM” create significant difficulties in adopting the standard at a jurisdictional level?

**PROPOSED INTERNATIONAL STANDARD ON QUALITY MANAGEMENT 1  
(PREVIOUSLY INTERNATIONAL STANDARD ON QUALITY CONTROL 1) –  
QUALITY MANAGEMENT FOR FIRMS THAT PERFORM AUDITS OR REVIEWS OF  
FINANCIAL STATEMENTS, OR OTHER ASSURANCE OR RELATED SERVICES  
ENGAGEMENTS**

(Effective as of TBD)

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Appendix 1: The Components of a System of Quality Management

Proposed International Standard on Quality Management (ISQM) 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*, should be read in conjunction with the *Preface to the International Quality Management, Auditing, Review, Other Assurance, and Related Services Pronouncements*.



## Introduction

### Scope of this ISQM

1. This International Standard on Quality Management (ISQM) deals with a firm's responsibilities to design, implement and operate a system of quality management for audits or reviews of financial statements, or other assurance or related services engagements. ISQM 2<sup>19</sup> deals with the responsibility of the firm and engagement quality reviewers relating to engagement quality reviews. This ISQM is to be read in conjunction with relevant ethical requirements.
2. Other pronouncements of the International Auditing and Assurance Standards Board (IAASB) include requirements for engagement partners and other personnel regarding quality management at the engagement level. ISA 220 (Revised),<sup>20</sup> for example, deals with the specific responsibilities of the auditor regarding quality management at the engagement level for an audit of financial statements and the related responsibilities of the engagement partner. (Ref: Para. A1)
3. Law, regulation or relevant ethical requirements may establish responsibilities for the firm's management of quality beyond those described in this ISQM.
4. This ISQM applies to all firms performing audits or reviews of financial statements, or other assurance or related services engagements (i.e., if the firm performs any of these engagements, this ISQM applies).

### Scalability

5. This ISQM requires the firm to apply a risk-based approach in the design, implementation and operation of the system of quality management, taking into account:
  - (a) The nature and circumstances of the firm, including whether it is part of a network or uses service providers; and (Ref: Para. A22)
  - (b) The nature and circumstances of the engagements performed by the firm, including the types of engagements performed by the firm and the types of entities for which such engagements are performed. (Ref: Para. A23)

Accordingly, the complexity and formality of firms' systems of quality management will vary. For example, a firm that performs different types of engagements for a wide variety of entities, including audits of financial statements of listed entities or entities that are of significant public interest, will likely need to have a more complex and more formal system of quality management than a firm that performs only reviews of financial statements or compilation engagements.

6. The nature and circumstances of the firm and its engagements may change over time. This ISQM requires the firm to identify such changes and respond appropriately.

### The Firm's System of Quality Management

7. The purpose of a system of quality management is to support the consistent performance of quality engagements, by providing the firm with reasonable assurance that the objectives of the system, stated in paragraph 18(a) and (b), are achieved. The public interest is served by the consistent performance of quality engagements. Quality engagements are achieved through planning and

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<sup>19</sup> Proposed ISQM 2, *Engagement Quality Reviews*

<sup>20</sup> Proposed International Standard on Auditing (ISA) 220 (Revised), *Quality Management for an Audit of Financial Statements*

performing engagements and reporting on them in accordance with professional standards and applicable legal and regulatory requirements. Achieving the objectives of those standards and complying with the requirements of applicable law or regulation involves exercising professional judgment and, when applicable to the type of engagement, exercising professional skepticism. (Ref: Para. A2–A4)

8. This ISQM requires professional judgment to be exercised in designing, implementing and operating the firm's system of quality management. A system of quality management is a continual and iterative process and is responsive to changes in the nature and circumstances of the firm and its engagements. It also does not operate in a linear manner. However, for the purposes of this ISQM, a system of quality management addresses the following eight components, which are highly integrated: (Ref: Para. A4–A5)
- (a) Governance and leadership;
  - (b) The firm's risk assessment process;
  - (c) Relevant ethical requirements;
  - (d) Acceptance and continuance of client relationships and specific engagements;
  - (e) Engagement performance;
  - (f) Resources;
  - (g) Information and communication; and
  - (h) The monitoring and remediation process.

A further description of each of the eight components and their interrelationships is included in Appendix 1.

9. The firm's governance and leadership component establishes the environment in which the system of quality management operates because this component addresses the firm's culture, decision-making process, actions, organizational structure and leadership. This standard requires that the firm's leadership demonstrate a commitment to quality through their actions and behaviors and establish the expected behavior of personnel within the firm.
10. In taking a risk-based approach to quality management, the firm applies the firm's risk assessment process to the other components. The firm's risk assessment process consists of:
- (a) Establishing quality objectives. The quality objectives established by the firm consist of objectives that, when achieved by the firm, collectively provide the firm with reasonable assurance that the objectives of the system of quality management, stated in paragraph 18(a) and (b), are achieved. The firm is required to establish the quality objectives set out in this ISQM and additional quality objectives beyond those required by this ISQM, when those objectives are necessary to achieve the objective of this ISQM.
  - (b) Identifying and assessing risks to the achievement of the firm's quality objectives (referred to in this standard as quality risks). The firm is required to identify and assess quality risks to provide a basis for designing and implementing responses.
  - (c) Designing and implementing responses to address the assessed quality risks. The nature, timing and extent of the firm's responses to address the assessed quality risks will be based on, and responsive to, the reasons for the assessments given to the quality risks. The firm is

required to include the responses required by this ISQM, which are organized by component, in its responses to its assessed quality risks. The responses required by this ISQM are relevant to every firm's system of quality management, and are therefore applicable to all firms. However, the responses required by this ISQM alone will not be sufficient to address all of the firm's assessed quality risks for the quality objectives that are required to be established by this ISQM.

11. This ISQM includes components that address specific topics that are fundamental for the performance of audits or reviews of financial statements, or other assurance or related services engagements (i.e., relevant ethical requirements, acceptance and continuance of client relationships and specific engagements, and engagement performance). In addition, it includes components for resources and information and communication, which are necessary to enable the operation of all the other components of the system of quality management.
12. This ISQM requires the firm to evaluate the design, implementation and operation of its system of quality management through a monitoring and remediation process, which involves:
  - (a) Designing and performing monitoring activities and evaluating the findings from such activities, the results of external inspections and other relevant information to determine whether deficiencies exist in the system of quality management;
  - (b) Investigating the root cause(s) of the identified deficiencies and evaluating the severity and pervasiveness of the identified deficiencies; and
  - (c) Remediating the identified deficiencies.

The findings arising from the monitoring may also highlight positive practices that the firm uses to enhance its system of quality management. The monitoring and remediation process provides information that is the basis for the evaluation of whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.

13. All of the components of the system of quality management operating together enable the consistent performance of quality engagements and contribute to the firm achieving the objective of this ISQM. Accordingly, other pronouncements of the IAASB, such as ISA 220 (Revised),<sup>21</sup> are premised on the basis that the firm is subject to the ISQMs or to national requirements that are at least as demanding.

### *Networks*

14. In some circumstances, the firm may belong to a network. This ISQM includes requirements for firms that operate as part of a network, in recognition that networks may establish requirements regarding the firm's system of quality management or may make services or resources available that the firm may choose to implement or use in the design, implementation and operation of its system of quality management. Network requirements or network services are further described in paragraph 58 of this ISQM. Such requirements or services may be intended to promote the consistent performance of quality engagements across the firms that operate as part of the network. Notwithstanding the firm's compliance with the network requirements or use of the network services, the firm remains responsible for its system of quality management.

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<sup>21</sup> Proposed ISA 220 (Revised), paragraph 3

### *Service Providers*

15. This ISQM also includes requirements for circumstances when the firm intends to obtain or use resources provided by a service provider in its system of quality management.

### **Authority of this ISQM**

16. This ISQM contains the objective of the firm in following this ISQM, and requirements designed to enable the firm to meet that stated objective. In addition, it contains related guidance in the form of application and other explanatory material and introductory material that provides context relevant to a proper understanding of this ISQM, and definitions. (Ref: Para. A6–A9)

### **Effective Date**

17. Systems of quality management in compliance with this ISQM are required to be established by TBD.

### **Objective**

18. The objective of the firm is to design, implement and operate a system of quality management for audits or reviews of financial statements, or other assurance or related services engagements performed by the firm, that provides the firm with reasonable assurance that:
- (a) The firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements; and
  - (b) Engagement reports issued by the firm or engagement partners are appropriate in the circumstances.

### **Definitions**

19. In this ISQM, the following terms have the meanings attributed below:
- (a) Deficiency in the firm’s system of quality management (referred to as “deficiency” in this ISQM) – This exists when:
    - (i) A quality objective required to achieve the objective of this ISQM is not established;
    - (ii) A quality risk has not been appropriately identified or assessed, such that a response that addresses that risk has not been appropriately designed or implemented; or
    - (iii) A response to address an assessed quality risk is not properly designed, implemented or operating effectively. (Ref: Para. A10)
  - (b) Engagement documentation – The record of work performed, results obtained, and conclusions the practitioner reached (terms such as “working papers” or “work papers” are sometimes used).
  - (c) Engagement partner<sup>22</sup> – The partner or other individual, appointed by the firm, who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.

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<sup>22</sup> “Engagement partner” and “partner” should be read as referring to their public sector equivalents where relevant.

- (d) Engagement quality review – An objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon, performed by the engagement quality reviewer and completed on or before the date of the engagement report.
- (e) Engagement quality reviewer – A partner, other individual in the firm, or an external individual appointed by the firm to perform the engagement quality review.
- (f) Engagement team – All partners and staff performing the engagement, and any other individuals who perform procedures on the engagement, including individuals engaged by the firm or a network firm. The engagement team excludes an external expert engaged by the firm or by a network firm, and also excludes individuals within the client’s internal audit function who provide direct assistance on an audit engagement when the external auditor complies with the requirements of ISA 610 (Revised 2013).<sup>23</sup>
- (g) External inspections – Inspections or investigations undertaken by an external oversight authority related to the firm’s system of quality management or engagements performed by the firm. (Ref: Para. A11)
- (h) Firm – A sole practitioner, partnership or corporation or other entity of professional accountants, or public sector equivalent. (Ref: Para. A12)
- (i) 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.
- (j) Network firm – A firm or entity that belongs to a network.
- (k) Network<sup>24</sup> – A larger structure: (Ref: Para. A13–A14)
  - (i) That is aimed at cooperation, and
  - (ii) That is clearly aimed at profit or cost-sharing or shares common ownership, control or management, common quality management policies or procedures, common business strategy, the use of a common brand name, or a significant part of professional resources.
- (l) Partner – Any individual with authority to bind the firm with respect to the performance of a professional services engagement.
- (m) Personnel – Partners and staff.
- (n) Professional judgment – The application of relevant training, knowledge and experience, within the context of professional standards, in making informed decisions about the courses of action that are appropriate in the design, implementation and operation of the firm’s system of quality management.

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<sup>23</sup> ISA 610 (Revised 2013), *Using the Work of Internal Auditors*, establishes limits on the use of direct assistance. It also acknowledges that the external auditor may be prohibited by law or regulation from obtaining direct assistance from internal auditors. Therefore, the use of direct assistances is restricted to situations where it is permitted.

<sup>24</sup> As defined in the International Ethics Standards Board for Accountants’ *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA Code)

- (o) Professional standards – IAASB Engagement Standards, as defined in the IAASB’s *Preface to the International Quality Management, Auditing, Review, Other Assurance and Related Services Pronouncements*, and relevant ethical requirements.
- (p) Quality objectives – The objectives that, when achieved by the firm, collectively provide the firm with reasonable assurance that the objectives of the system of quality management are achieved.
- (q) Quality risks – Risks arising from conditions, events, circumstances, actions or inactions that may adversely affect the achievement of a quality objective(s).
- (r) Reasonable assurance – In the context of the ISQMs, a high, but not absolute, level of assurance.
- (s) Relevant ethical requirements – Principles of professional ethics and ethical requirements that are applicable to professional accountants when undertaking engagements that are audits or reviews of financial statements or other assurance or related services engagements. Relevant ethical requirements ordinarily comprise the provisions of the IESBA Code related to audits or reviews of financial statements, or other assurance or related services engagements, together with national requirements that are more restrictive. (Ref: Para. A15–A16, A67)
- (t) Response (in relation to a system of quality management) – Policies or procedures designed and implemented by the firm to address an assessed quality risk: (Ref: Para. A17–A18, A62)
  - (i) Policies are statements of what should, or should not, be done to address an assessed quality risk. Such statements may be documented, explicitly stated in communications or implied through actions and decisions.
  - (ii) Procedures are actions to implement policies.
- (u) Staff – Professionals, other than partners, including any experts the firm employs.
- (v) System of quality management – A system designed, implemented and operated by a firm to provide reasonable assurance that:
  - (i) The firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements; and
  - (ii) Engagement reports issued by the firm or engagement partners are appropriate in the circumstances.

## Requirements

### Applying, and Complying with, Relevant Requirements

20. The individual(s) assigned ultimate responsibility and accountability, and the individual(s) assigned operational responsibility, for the firm’s system of quality management shall have an understanding of this ISQM relevant to their responsibilities, including the application and other explanatory material, to understand the objective of this ISQM and to apply its requirements properly. (Ref: Para. A19)
21. The firm shall comply with each requirement of this ISQM unless the requirement is not relevant to the firm because of the nature and circumstances of the firm or its engagements. (Ref: Para. A20)

## **System of Quality Management**

22. The firm shall design, implement and operate a system of quality management that complies with the requirements of this ISQM. The requirements are designed to enable the firm to achieve the objective stated in this ISQM. The proper application of the requirements in this ISQM is expected to provide a sufficient basis for the achievement of the objective of this standard. In applying the requirements of this ISQM, the firm shall exercise professional judgment, taking into account the nature and circumstances of the firm and its engagements, such that the objective of this ISQM is achieved. (Ref: Para. A21–A24)

## **Governance and Leadership**

23. The firm shall establish the following quality objectives that address the aspects of the firm's environment that support the design, implementation and operation of the other components of the system of quality management, including the firm's culture, decision-making process, actions, organizational structure and leadership:
- (a) The firm's culture promotes a commitment to quality, including recognizing and reinforcing the importance of professional ethics, values and attitudes throughout the firm and emphasizing the responsibility of all personnel for quality relating to the performance of engagements or activities within the system of quality management. (Ref: Para. A26–A28)
  - (b) The firm has leadership who is responsible and accountable for quality. (Ref: Para. A36)
  - (c) The firm's strategic decisions and actions, including financial and operational priorities, demonstrate a commitment to quality and to the firm's role in serving the public interest, by consistently performing quality engagements. (Ref: Para. A29–A30)
  - (d) The firm has an organizational structure with appropriate assignment of roles, responsibilities and authority that supports the firm's commitment to quality and the design, implementation and operation of the firm's system of quality management. (Ref: Para. A31–A32)
  - (e) The firm plans for its resource needs, including financial resources, and obtains, allocates or assigns resources in a manner that supports the firm's commitment to quality and enables the design, implementation and operation of the firm's system of quality management. (Ref: Para. A33–A35)
  - (f) The firm fulfills its responsibilities in accordance with law, regulation and professional standards that relate to the governance and leadership of the firm, if applicable. (Ref: Para. A25)
24. In designing and implementing responses to address the quality risks identified and assessed by the firm relating to the governance and leadership quality objectives, the firm shall include the following responses:
- (a) Assigning ultimate responsibility and accountability for the system of quality management to the firm's chief executive officer or the firm's managing partner (or equivalent) or, if appropriate, the firm's managing board of partners (or equivalent). The individual(s) to whom such responsibility and accountability is assigned shall: (Ref: Para. A36)
    - (i) Have the appropriate experience and knowledge to fulfill the assigned responsibility.
    - (ii) Demonstrate a commitment to quality through their actions and behaviors, including recognizing and reinforcing the importance of professional ethics, values and attitudes,

- and establishing the expected behavior of personnel relating to the performance of engagements and activities within the system of quality management. (Ref: Para. A26–A28)
- (iii) Establish structures, reporting lines, and appropriate authorities and responsibilities, including assigning operational responsibility for the following matters to personnel who fulfill the requirements in paragraph 25: (Ref: Para. A37–A39)
- a. The system of quality management as a whole; and
  - b. Specific aspects of the system of quality management, as appropriate to the nature and circumstances of the firm, which shall include operational responsibility for compliance with independence requirements and the monitoring and remediation process.
- (b) Establishing policies or procedures for periodic performance evaluations of the individual(s) assigned ultimate responsibility and accountability for the firm’s system of quality management, and the individual(s) assigned operational responsibility for the matters set out in paragraph 24(a)(iii), in order to hold individuals accountable for the responsibilities assigned to them. (Ref: Para. A40–A43)
- (c) Establishing policies or procedures for dealing with complaints and allegations about the commitment to quality of the firm or its personnel, including clearly defining channels within the firm that enable reporting by personnel or external parties to appropriate individual(s) without fear of reprisal and enabling the investigation and resolution of the complaints and allegations. (Ref: Para. A44–A47)
25. The personnel assigned operational responsibility for the matters set out in paragraph 24(a)(iii) shall have: (Ref: Para. A39)
- (a) The appropriate experience and knowledge and sufficient time to fulfill their assigned responsibility;
  - (b) A direct line of communication to the individual(s) assigned ultimate responsibility and accountability for the system of quality management; and
  - (c) An understanding of their assigned responsibilities and accountability for such responsibilities.

### **The Firm’s Risk Assessment Process**

26. The firm shall establish the quality objectives required by this ISQM. The firm shall also establish additional quality objectives beyond those required by this ISQM, when those objectives are necessary to achieve the objective of this ISQM. (Ref: Para. A48–A51)
27. The firm shall understand the conditions, events, circumstances, actions or inactions that may adversely affect the achievement of its quality objectives, taking into account the nature and circumstances of the firm and its engagements, to provide the basis for the identification and assessment of quality risks. (Ref: Para. A48, A52)
28. Based on the understanding obtained in paragraph 27, the firm shall identify those quality risks, before consideration of any responses, that: (Ref: Para. A48, A53–A54)
- (a) Have a reasonable possibility of occurring; and (Ref: Para. A55)



- (b) If they were to occur, may individually or in combination with other quality risks, have a significant effect on the achievement of a quality objective(s). (Ref: Para. A56–A57)
29. The firm shall assess the quality risks identified in paragraph 28 to provide a basis for the design and implementation of the related responses. (Ref: Para. A48, A58)
30. The firm shall design and implement responses to address the assessed quality risks, including the responses required by this ISQM. The design of the responses shall be based on, and responsive to, the reasons for the assessments given to the quality risks. (Ref: Para. A48, A59–A64)

#### *Changes in the Nature and Circumstances of the Firm or its Engagements*

31. The firm shall identify changes in the nature and circumstances of the firm or its engagements and modify the quality objectives, quality risks or responses, as appropriate, in response to such changes. (Ref: Para. A48, A65–A66)

#### **Relevant Ethical Requirements**

32. The firm shall establish the following quality objectives that address the fulfillment of responsibilities in accordance with relevant ethical requirements, which, as defined, include the principles of professional ethics: (Ref: Para. A67)
- (a) The firm, its personnel and others subject to relevant ethical requirements understand the relevant ethical requirements, including those related to independence.
  - (b) The firm, its personnel and others subject to relevant ethical requirements fulfill their responsibilities in relation to the relevant ethical requirements, including those related to independence.
  - (c) The firm, its personnel and others subject to relevant ethical requirements identify and appropriately respond to breaches of the relevant ethical requirements, including those related to independence, in a timely manner.
33. In designing and implementing responses to address the quality risks identified and assessed by the firm relating to the relevant ethical requirements quality objectives, the firm shall include the following responses: (Ref: Para. A68–A69 and A75)
- (a) Identifying the relevant ethical requirements and determining the applicability of the relevant ethical requirements to the firm, its personnel and others, including, as applicable, the network, network firms, personnel in the network or network firms, or service providers. (Ref: Para. A15, A70–A71)
  - (b) Establishing policies or procedures that address the identification and evaluation of threats to compliance with the relevant ethical requirements and how identified threats should be addressed. (Ref: Para. A72)
  - (c) Establishing policies or procedures that address the identification, communication, evaluation and reporting of breaches and actions to address the causes and consequences of the breaches. (Ref: Para. A73–A74)
  - (d) Obtaining, at least annually, a documented confirmation of compliance with independence requirements from all personnel required by relevant ethical requirements to be independent.

### **Acceptance and Continuance of Client Relationships and Specific Engagements**

34. The firm shall establish the following quality objectives that address the acceptance and continuance of client relationships and specific engagements that are appropriate in the circumstances: (Ref: Para. A76)
- (a) The firm obtains sufficient appropriate information about the nature and circumstances of the engagement and the integrity and ethical values of the client (including management, and, when appropriate, those charged with governance) and based on such information makes appropriate judgments about whether to accept or continue a client relationship or specific engagement. (Ref: Para. A77–A82)
  - (b) The firm makes appropriate judgments about the firm’s ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements when determining whether to accept or continue a client relationship or specific engagement, including that the firm has: (Ref: Para. A83)
    - (i) Resources to perform the engagement; and (Ref: Para. A84)
    - (ii) Access to information to perform the engagement, or to the persons who provide such information.
  - (c) The firm’s financial and operational priorities do not lead to inappropriate judgments about whether to accept or continue a client relationship or specific engagement. (Ref: Para. A85–A86)
  - (d) The firm responds appropriately in circumstances when the firm becomes aware of information subsequent to accepting or continuing a client relationship or specific engagement that would have caused it to decline the client relationship or specific engagement had that information been known prior to accepting or continuing the client relationship or specific engagement. (Ref: Para. A87–A88)
35. In designing and implementing responses to address the quality risks identified and assessed by the firm relating to the acceptance and continuance quality objectives, the firm shall include policies or procedures that address circumstances when the firm is obligated by law or regulation to accept the client relationship or specific engagement, if applicable. (Ref: Para. A89–A90)

### **Engagement Performance**

36. The firm shall establish the following quality objectives that address the performance of quality engagements:
- (a) Personnel understand and fulfill their responsibilities in connection with the engagement, including, as applicable:
    - (i) The engagement partner’s overall responsibility for managing and achieving quality on the engagement and for being sufficiently and appropriately involved throughout the engagement; and (Ref: Para. A91)
    - (ii) The appropriate direction and supervision of the engagement team and review of the work performed. (Ref: Para. A92–A93)

- (b) Engagement teams exercise appropriate professional judgment and, when applicable to the type of engagement, professional skepticism, in planning and performing engagements such that conclusions reached are appropriate. (Ref: Para. A94–A97)
  - (c) The engagement documentation is appropriately assembled and retained.
37. In designing and implementing responses to address the quality risks identified and assessed by the firm relating to the engagement performance quality objectives, the firm shall include the following responses:
- (a) Establishing policies or procedures addressing the nature, timing and extent of the direction and supervision of engagement teams and review of their work, including that such direction, supervision and review is planned and performed on the basis that the work performed by less experienced members of the engagement team is directed, supervised and reviewed by more experienced engagement team members. (Ref: Para. A92–A93)
  - (b) Communicating to engagement teams their responsibility for planning and performing the engagement in accordance with professional standards and applicable legal and regulatory requirements.
  - (c) Establishing policies or procedures addressing consultation on difficult or contentious matters, including the engagement team’s responsibilities for consultation, the matters on which consultation is required and how the conclusions should be agreed and implemented. (Ref: Para. A95, A98–A99)
  - (d) Establishing policies or procedures addressing differences of opinion that arise within the engagement team, or between the engagement team and the engagement quality reviewer or personnel performing activities within the firm’s system of quality management, including those who provide consultation. (Ref: Para. A95, A100)
  - (e) Establishing policies or procedures addressing engagement quality reviews in accordance with ISQM 2, and that require an engagement quality review for: (Ref: Para. A101–A107)
    - (i) Audits of financial statements of listed entities;
    - (ii) Audits of financial statements of entities that the firm determines are of significant public interest; and
    - (iii) Audits or other engagements for which:
      - a. An engagement quality review is required by law or regulation; or
      - b. The firm determines that an engagement quality review is an appropriate response to assessed quality risks, based on the reasons for the assessments given to those risks.
  - (f) Establishing policies or procedures addressing assembly and retention of documentation that require:
    - (i) The engagement files to be assembled within an appropriate period of time after the engagement reports have been finalized; and (Ref: Para. A108)
    - (ii) The engagement documentation to be retained and maintained to meet the needs of the firm and to comply with law, regulation, relevant ethical requirements, or other professional standards. (Ref: Para. A109–A112)

## Resources

38. The firm shall establish the following quality objectives that address appropriately obtaining, developing, using, maintaining, allocating and assigning resources, including human resources, technological resources, and intellectual resources, in a timely manner to enable the design, implementation and operation of the system of quality management: (Ref: Para. A113–A116)
- (a) The firm hires, develops and retains personnel, including engagement partners, who have the competence and capabilities to: (Ref: Para. A117–A119)
    - (i) Consistently perform quality engagements, including knowledge or experience regarding professional standards and applicable law or regulation relevant to the engagements the firm performs; or
    - (ii) Perform activities or carry out responsibilities in relation to the operation of the firm's system of quality management.
  - (b) The firm assigns an engagement partner and other human resources to each engagement who have appropriate competence and capabilities, including being given sufficient time, to consistently perform quality engagements. (Ref: Para. A120)
  - (c) The firm assigns human resources to perform activities within the system of quality management who have appropriate competence and capabilities, including sufficient time, to perform such activities. (Ref: Para. A120)
  - (d) Personnel demonstrate a commitment to quality through their actions and behaviors, develop and maintain the appropriate competence to perform their roles, and are held accountable through timely evaluations, compensation, promotion and other incentives. (Ref: Para. A121–A123)
  - (e) The firm obtains or develops, implements and maintains appropriate technological resources to enable the operation of the firm's system of quality management and the performance of engagements. (Ref: Para. A124–A131)
  - (f) The firm obtains or develops, implements and maintains appropriate intellectual resources to enable the consistent performance of quality engagements, and such intellectual resources are consistent with professional standards and applicable legal and regulatory requirements, where applicable. (Ref: Para. A132–A133)
  - (g) Personnel appropriately use the firm's technological and intellectual resources. (Ref: Para. A134)
39. The firm shall design and implement responses to address the quality risks identified and assessed by the firm relating to the resources quality objectives.

## Information and Communication

40. The firm shall establish the following quality objectives that address obtaining, generating or using information regarding the system of quality management, and communicating information within the firm and to external parties on a timely basis to enable the design, implementation and operation of the system of quality management: (Ref: Para. A135)

- (a) The firm has an information system that supports the system of quality management by identifying, capturing, processing and maintaining relevant and reliable information, whether from internal or external sources. (Ref: Para. A136–A138)
  - (b) The firm communicates relevant and reliable information to personnel, the nature, timing and extent of which is sufficient to enable personnel to understand and carry out their responsibilities relating to the performance of engagements or activities within the system of quality management. (Ref: Para. A139)
  - (c) The firm’s culture promotes and emphasizes the responsibility of personnel to exchange information with the firm and with one another. (Ref: Para. A139)
  - (d) Personnel communicate relevant and reliable information to the firm when performing engagements or activities within the system of quality management. (Ref: Para. A139)
  - (e) The firm communicates relevant and reliable information to external parties regarding the firm’s system of quality management, as the firm determines appropriate. (Ref: Para. A142–A153)
41. In designing and implementing responses to address the quality risks identified and assessed by the firm relating to the information and communication quality objectives, the firm shall include the following responses:
- (a) Establishing policies or procedures that address the nature, timing and extent of communication and matters to be communicated by the firm with engagement teams. (Ref: Para. A140)
  - (b) Communicating the responsibility for implementing the firm’s responses to relevant personnel, including engagement teams. (Ref: Para. A141)
  - (c) Establishing policies or procedures that address the nature, timing and extent of communication and matters to be communicated with external parties, including:
    - (i) Communication to external parties in accordance with law, regulation or professional standards. (Ref: Para. A142)
    - (ii) Communication with the network. (Ref: Para. A143)
    - (iii) Communication with service providers. (Ref: Para. A144)
    - (iv) Other communication to external parties about the firm’s system of quality management, in a transparency report or otherwise, when the firm determines it appropriate to do so, taking into account: (Ref: Para. A145, A149–A153)
      - a. Whether there are external parties who may use such information to support their understanding of the quality of the engagements performed by the firm; and (Ref: Para. A146–A147)
      - b. The nature and circumstances of the firm, including the nature of the firm’s operating environment. (Ref: Para. A148)

### **Monitoring and Remediation Process**

42. The firm shall establish the following quality objectives that address the firm’s monitoring and remediation process that enable the evaluation of the design, implementation and operation of the

components of the system of quality management to determine whether the quality objectives have been achieved: (Ref: Para. A154–A155)

- (a) The firm's monitoring and remediation process provides relevant, reliable and timely information about the design, implementation and operation of the components of the system of quality management.
  - (b) The firm takes appropriate actions to respond to identified deficiencies such that deficiencies are remediated on a timely basis.
  - (c) The individual(s) assigned ultimate responsibility and accountability for the system of quality management evaluates whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.
43. In designing and implementing responses to address the quality risks identified and assessed by the firm relating to the monitoring and remediation quality objectives, the firm shall include the responses in paragraphs 44–57.

#### *Designing and Performing Monitoring Activities*

44. The firm shall determine the nature, timing and extent of the monitoring activities, including the appropriate combination of ongoing and periodic monitoring activities. In designing and implementing the monitoring activities, the firm shall take into account: (Ref: Para. A156–A159)
- (a) For a response, the related assessed quality risk(s), the reasons for the assessments given to the quality risk(s) and the design of the response; (Ref: Para. A160–A161)
  - (b) For monitoring activities over the firm's risk assessment process, the design of that process;
  - (c) Changes in factors that have affected the firm's system of quality management or changes in the system of quality management; (Ref: Para. A162)
  - (d) Previous monitoring activities and remedial actions, including whether previous monitoring activities continue to be relevant in evaluating the firm's system of quality management; and (Ref: Para. A163–A164)
  - (e) Other relevant information, including concerns identified regarding the commitment to quality of the firm or its personnel and information from external inspections. (Ref: Para. A165–A167)
45. The firm's monitoring activities shall include the inspection of engagements to determine whether the responses that are required to be implemented at the engagement level have been implemented. Engagement inspections may include the inspection of in-process or completed engagements. In determining the nature, timing and extent of the inspection of engagements, the firm shall: (Ref: Para. A168–A170)
- (a) Take into account the relevant factors in paragraph 44; and
  - (b) Include the inspection of at least one completed engagement for each engagement partner on a cyclical basis determined by the firm.
46. The firm shall establish policies or procedures that:
- (a) Require those performing the monitoring activities to have the competence and capabilities, including sufficient time, to perform the monitoring activities effectively; and

- (b) Address the objectivity of the individuals performing the monitoring activities. Such policies or procedures shall prohibit the engagement team members or the engagement quality reviewer of an engagement from performing any inspection of that engagement. (Ref: Para. A171)

#### *Evaluating Findings and Identifying Deficiencies*

- 47. The firm shall establish policies or procedures addressing the evaluation of the findings arising from the monitoring activities, the results of external inspections and other relevant information to determine whether deficiencies exist, including in the monitoring and remediation process. (Ref: Para. A165, A172–A177)

#### *Evaluating Identified Deficiencies*

- 48. The firm shall establish policies or procedures addressing:
  - (a) The investigation of the root cause(s) of the identified deficiencies, including that the nature, timing and extent of the procedures to be performed to investigate the root cause(s) take into account the nature of the identified deficiencies and their possible severity; and (Ref: Para. A178–A182)
  - (b) The evaluation of the severity and pervasiveness of the identified deficiencies, including the effect of the identified deficiencies, individually and in aggregate, on the system of quality management as a whole. (Ref: Para. A183)

#### *Responding to Identified Deficiencies*

- 49. The firm shall design and implement remedial actions to address identified deficiencies that are responsive to the results of the root cause analysis. In doing so, the firm shall determine whether the firm's quality objectives, assessed quality risks and responses remain appropriate and modify them, as appropriate. (Ref: Para. A184)
- 50. The individual(s) assigned operational responsibility for monitoring and remediation shall evaluate whether the remedial actions are appropriately designed to address the identified deficiencies and their related root cause(s) and determine whether they have been implemented. The individual shall also evaluate whether the remedial actions implemented to address previously identified deficiencies are effective. (Ref: Para. A163)

#### *Findings About a Particular Engagement*

- 51. In circumstances when a finding relates to an in-process or completed engagement and there is an indication that procedures required were omitted during the performance of the engagement or the report issued may be inappropriate, the firm shall: (Ref: Para. A185)
  - (a) Take appropriate action to comply with relevant professional standards and applicable legal and regulatory requirements; and
  - (b) When the report is considered to be inappropriate, consider the implications and take appropriate action, including considering whether to obtain legal advice.

#### *Ongoing Communication Related to Monitoring and Remediation*

- 52. The individual(s) assigned operational responsibility for the monitoring and remediation process shall communicate on a timely basis to the individual(s) assigned ultimate responsibility and accountability

for the system of quality management and the individual(s) assigned operational responsibility for the system of quality management: (Ref: Para. A186)

- (a) A description of the monitoring activities performed;
- (b) The identified deficiencies, including the severity and pervasiveness of such deficiencies; and
- (c) The remedial actions to address the identified deficiencies.

53. The firm shall communicate the matters described in paragraph 52 to personnel to the extent that the information is relevant to their responsibilities to enable the personnel to take prompt and appropriate action in accordance with their responsibilities. (Ref: Para. A187)

54. The firm shall communicate information about the results of the firm's monitoring and remediation process to external parties on a timely basis, in accordance with paragraph 41(c).

#### *Evaluating the System of Quality Management*

55. The individual(s) assigned ultimate responsibility and accountability for the system of quality management shall evaluate whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved. This evaluation shall take into account: (Ref: Para. A188–A189)

- (a) The severity and pervasiveness of identified deficiencies; and
- (b) The evaluation in paragraph 50 regarding whether the remedial actions are appropriately designed to address the identified deficiencies and their related root cause(s), and have been implemented.

56. The evaluation in paragraph 55 shall be undertaken at least annually, or more frequently when the identified deficiencies are of a severity and pervasiveness that indicate that the system may not be providing reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.

57. If the evaluation indicates that the system of quality management does not provide reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved, the individual(s) assigned ultimate responsibility and accountability for the system of quality management shall:

- (a) Take prompt and appropriate action in accordance with their responsibilities; and
- (b) Communicate to: (Ref: Para. A190–A191)
  - (i) Personnel to the extent that it is relevant to their responsibilities; and
  - (ii) External parties in accordance with the firm's policies or procedures required by paragraph 41(c).

#### **Network Requirements or Network Services**

58. When the firm operates as part of a network, the firm shall understand, when applicable:

- (a) The requirements established by the network regarding the firm's system of quality management, including requirements for the firm to implement or use resources or services designed or otherwise provided by or through the network (i.e., network requirements); (Ref: Para. A192)



- (b) Any services or resources provided by the network that the firm chooses to implement or use in the design, implementation or operation of the firm's system of quality management (i.e., network services); and (Ref: Para. A193)
- (c) The firm's responsibilities for any actions that are necessary to implement the network requirements or use network services. (Ref: Para. A194)

The firm remains responsible for its system of quality management, including professional judgments made in the design, implementation and operation of the system of quality management. The firm shall not allow compliance with the network requirements or use of network services to contravene the requirements of this ISQM. (Ref: Para. A13, A195–A196)

#### *The Firm's Risk Assessment Process*

59. In complying with the requirements in paragraphs 26–30, the firm shall evaluate the effect of the network requirements or network services on the firm's system of quality management, including determining whether they need to be adapted or supplemented by the firm to be appropriate for use in its system of quality management. (Ref: Para. A197–A198)

#### *Monitoring and Remediation Process*

60. In circumstances when the network performs monitoring activities relating to the firm's system of quality management, the firm shall:
- (a) Determine the effect of the monitoring activities performed by the network on the nature, timing and extent of the firm's monitoring activities performed in accordance with paragraphs 44–45; (Ref: Para. A199)
  - (b) Determine the firm's responsibilities in relation to the monitoring activities, including any related actions by the firm; and
  - (c) As part of evaluating findings and identifying deficiencies in paragraph 47, obtain the results of the monitoring activities from the network in a timely manner. (Ref: Para. A200)
61. The firm shall, at least annually, obtain information from the network, about the overall scope and results of the monitoring activities across the network firms' systems of quality management and:
- (a) Consider the effect of such information on the nature, timing and extent of the monitoring activities that need to be undertaken by the firm; and (Ref: Para. A201–A202)
  - (b) Communicate the information to personnel to the extent that it is relevant to their responsibilities such that personnel take prompt and appropriate action in accordance with their responsibilities (including as it relates to the performance of engagements).
62. As part of evaluating findings and identifying deficiencies in paragraph 47, if the firm identifies deficiencies in the network requirements or network services, the firm shall communicate to the network relevant information about the identified deficiencies. (Ref: Para. A203)
63. As part of designing and implementing remedial actions in paragraph 49, for identified deficiencies related to the network requirements or network services the firm shall: (Ref: Para. A204)
- (a) Understand the planned remedial actions by the network;
  - (b) Understand whether the network's remedial actions are designed and implemented to address the identified deficiencies and their related root cause(s); and

- (c) Determine the supplementary remedial actions needed by the firm, if any.

### **Service Providers**

64. When the firm intends to obtain or use resources provided by a service provider in its system of quality management, the firm's responses for resources shall include: (Ref: Para. A205–A207)
- (a) Obtaining an understanding of the service provider, including determining that the reputation, competence and capabilities of the service provider are appropriate in the context of the intended use of the resource; (Ref: Para. A208)
  - (b) Establishing the nature and scope of the resources provided by the service provider, including the firm's responsibilities for any actions that are necessary in using the resources; and (Ref: Para. A209)
  - (c) Determining whether the resource is appropriate for use in the system of quality management in the context of the quality risks identified and assessed by the firm and the reasons for the assessments given to the quality risks, including when changes are made to the resources provided. (Ref: Para. A210)

Notwithstanding the firm's use of a service provider(s), the firm remains responsible for its system of quality management.

65. As part of evaluating findings and identifying deficiencies in paragraph 47, if the firm identifies deficiencies in the resources provided by the service provider, the firm shall communicate to the service provider relevant information about the identified deficiencies. The firm shall also:
- (a) Understand the planned remedial actions by the service provider and consider whether the service provider's remedial actions are designed and implemented to address the identified deficiencies and their related root cause(s);
  - (b) Determine the supplementary remedial actions needed by the firm, if any; and
  - (c) Consider whether to continue using the services provided by the service provider.

### **Documentation**

66. The firm shall prepare documentation of its system of quality management that is sufficient to: (Ref: Para. A211–A213)
- (a) Support a consistent understanding of the system of quality management by personnel, including an understanding of their roles and responsibilities with respect to the firm's system of quality management;
  - (b) Support the consistent implementation and operation of the responses; and
  - (c) Provide evidence of the design, implementation and operation of the responses, such that the firm is able to evaluate the system of quality management.
67. The firm shall prepare documentation that includes: (Ref: Para. A214)
- (a) The firm's quality objectives and assessed quality risks;
  - (b) A description of the responses and how the firm's responses address the assessed quality risks; and

- (c) Regarding the monitoring and remediation process:
  - (i) Evidence of the monitoring activities performed;
  - (ii) The evaluation of the findings from the monitoring activities, results of external inspections and other relevant information, including the identified deficiencies and their related root cause(s);
  - (iii) Remedial actions to address identified deficiencies and the evaluation of the design and implementation of such remedial actions;
  - (iv) Communications about monitoring and remediation; and
  - (v) The basis for the evaluation of whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.
- 68. The firm shall document the matters in paragraph 67 as they relate to network requirements or network services or resources provided by service providers and:
  - (a) The evaluation of the effect of the network requirements or network services in accordance with paragraph 59 and the conclusions reached.
  - (b) The firm's basis for determining that it is appropriate to use the resources from a service provider in its system of quality management.
- 69. The firm shall establish a period of time for the retention of documentation for the system of quality management that is sufficient to permit those performing monitoring procedures to evaluate the firm's system of quality management, or for a longer period if required by law or regulation.

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## Application and Other Explanatory Material

### Scope of this ISQM (Ref: Para. 2)

- A1. Other pronouncements of the IAASB, including ISRE 2400 (Revised)<sup>25</sup> and ISAE 3000 (Revised),<sup>26</sup> also establish requirements for the engagement partner for the management of quality at the engagement level.

### The Firm's System of Quality Management (Ref: Para. 7–8)

- A2. The IESBA Code contains requirements and application material for professional accountants that enable professional accountants to meet their responsibility to act in the public interest. In the context of engagement performance as described in this ISQM, the consistent performance of quality engagements forms part of the professional accountant's responsibility to act in the public interest.
- A3. Reasonable assurance is obtained when the firm's system of quality management reduces to an acceptably low level the risk that the objectives stated in paragraph 18(a) and (b) are not achieved. Reasonable assurance is not an absolute level of assurance, because there are inherent limitations

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<sup>25</sup> International Standard on Review Engagements (ISRE) 2400 (Revised), *Engagements to Review Historical Financial Statements*

<sup>26</sup> International Standard on Assurance Engagements (ISAE) 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*

of a firm's system of quality management. Such limitations include reality that human judgment in decision making can be faulty and that breakdowns in the firm's system of quality management may occur, for example, due to human error or behavior or failures in the firm's IT applications.

- A4. The design, implementation and operation of the system of quality management involves the exercise of professional judgment, including when making decisions about:
- The appropriate organizational structure and assignment of roles, responsibilities and authority that support the firm's commitment to quality.
  - Establishing additional quality objectives beyond those required by this ISQM when those objectives are necessary to achieve the objective of this standard.
  - The identification and assessment of the quality risks.
  - The appropriate nature, timing and extent of the responses to address the assessed quality risks.
  - The resources and information and communication that are appropriate to enable the design, implementation and operation of the components of the system of quality management.
  - The evaluation of whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.
  - The effect of the network requirements or network services on the firm's system of quality management.
- A5. The firm may use different terminology or frameworks to describe the components of its system of quality management.

**Authority of this ISQM** (Ref: Para. 16)

- A6. The objective of this ISQM provides the context in which the requirements of this ISQM are set, establishes the desired outcome of this ISQM and is intended to assist the firm in understanding what needs to be accomplished and, where necessary, the appropriate means of doing so.
- A7. The requirements of this ISQM are expressed using "shall."
- A8. Where necessary, the application and other explanatory material provides further explanation of the requirements and guidance for carrying them out. In particular, it may:
- Explain more precisely what a requirement means or is intended to cover; and
  - Include examples that illustrate how the requirements might be applied.

While such guidance does not in itself impose a requirement, it is relevant to the proper application of the requirements. The application and other explanatory material may also provide background information on matters addressed in this ISQM. Where appropriate, additional considerations specific to public sector audit organizations are included within the application and other explanatory material. These additional considerations assist in the application of the requirements in this ISQM. They do not, however, limit or reduce the responsibility of the firm to apply and comply with the requirements in this ISQM.

- A9. This ISQM includes, under the heading "Definitions," a description of the meanings attributed to certain terms for purposes of this ISQM. These definitions are provided to assist in the consistent

application and interpretation of this ISQM, and are not intended to override definitions that may be established for other purposes, whether in law, regulation or otherwise. The Glossary of Terms relating to International Standards issued by the IAASB in the *Handbook of International Quality Management, Auditing, Review, Other Assurance, and Related Services Pronouncements* published by IFAC includes the terms defined in this ISQM. The Glossary of Terms also includes descriptions of other terms found in the ISQMs to assist in common and consistent interpretation and translation.

## Definitions

### *Deficiencies* (Ref: Para. 19(a))

A10. A response to address an assessed quality risk is not:

- Properly designed when a response necessary to address an assessed quality risk is absent or a response is not properly designed in a manner that effectively addresses an assessed quality risk, such that a quality objective may not be achieved. A deficiency in the design of a response may also arise from a quality objective or assessed quality risk not being appropriately specific, given the nature and circumstances of the firm and its engagements.
- Operating effectively when a response that is properly designed does not operate as designed, which results in the related quality risk not being effectively addressed such that a quality objective may not be achieved.

### *External Inspections* (Ref: Para. 19(g))

A11. In some circumstances, an external oversight authority may undertake other types of reviews, for example, reviews of specific areas of focus that contribute to the improvement of engagement quality. Paragraph A165 describes such reviews as part of other relevant information considered by the firm in the monitoring and remediation component.

### *Firm* (Ref: Para. 19(h))

A12. The definition of “firm” in relevant ethical requirements may differ from the definition set out in this ISQM.

### *Network* (Ref: Para. 19(k), 58)

A13. Networks and the firms within the network may be structured in a variety of ways; however, in all cases networks are external to the firm. In some instances, network firms may provide services (e.g., resources) that are used by the firm in its system of quality management. There may also be circumstances when the network includes other structures or organizations that establish requirements for the firm related to its system of quality management, or provides services. For the purposes of this ISQM, any requirements established by the network regarding the firm’s system of quality management or services or resources provided by the network that the firm chooses to implement or use in its system of quality management that are obtained from the network, network firms or another structure or organization in the network are considered “network requirements or network services.”

A14. The IESBA Code provides guidance in relation to the terms “network” and “network firm.”

*Relevant Ethical Requirements* (Ref: Para. 19(s), 33(a))

- A15. The relevant ethical requirements that are applicable in the context of a system of quality management may vary, depending on the nature and circumstances of the firm and its engagements. The term “professional accountant” may be defined in relevant ethical requirements. For example, the IESBA Code defines the term “professional accountant” and further explains the scope of provisions in the IESBA Code that apply to individual professional accountants in public practice and their firms.
- A16. The IESBA Code addresses circumstances when law or regulation precludes the professional accountant from complying with certain parts of the IESBA Code. It further acknowledges that some jurisdictions might have provisions in law or regulation that differ from or go beyond those set out in the IESBA Code and that professional accountants in those jurisdictions need to be aware of those differences and comply with the more stringent provisions, unless prohibited by law or regulation.

*Response* (Ref: Para. 19(t))

- A17. Policies are implemented through the actions of personnel and other individuals whose actions are subject to the policies, or through their restraint from taking actions that would conflict with the firm’s policies.
- A18. Procedures may be mandated, through formal documentation or other communications, or may be effected by behaviors that are not mandated but are rather conditioned by the firm’s culture. Procedures may be enabled through the application of IT, for example, the firm may use an IT application to facilitate obtaining a documented confirmation of compliance with independence requirements from personnel.

**Applying, and Complying with, Relevant Requirements** (Ref: Para. 20–21)

- A19. The individual(s) assigned ultimate responsibility and accountability for the system of quality management may also assume operational responsibility for the system of quality management, for example, in smaller firms.
- A20. Examples of when a requirement of this ISQM may not be relevant to the firm include:
- When the firm is a sole practitioner. For example, the requirements addressing the organizational structure and assigning roles, responsibilities and authority within the firm, appropriate direction, supervision and review and addressing differences of opinion may not be relevant.
  - When the firm only performs engagements that are related services engagements. For example, if the firm is not required to maintain independence for the related services engagements, the requirement to obtain a documented confirmation of compliance with independence requirements from all personnel would not be relevant.

**System of Quality Management** (Ref: Para. 22)

- A21. Paragraph 55 requires the individual(s) assigned ultimate responsibility and accountability for the system of quality management to evaluate whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.
- A22. The nature and circumstances of the firm may include consideration of matters such as:

- The size and operating characteristics of the firm, including the geographical dispersion and the extent to which the firm concentrates or centralizes its processes or activities.
- The firm's strategic decisions and actions, including those about financial and operational matters.
- External factors, for example, law or regulation, economic stability, stakeholder expectations and social factors.
- In the case of a firm that belongs to a network, the nature of the network, how the network is organized and the nature and extent of the requirements established by the network regarding the firm's system of quality management or services or resources provided by the network that the firm chooses to implement or use in the design, implementation and operation of the firm's system of quality management.
- The extent to which the firm uses service providers in its system of quality management and the nature of such services.

A23. The nature and circumstances of the engagements performed by the firm may include consideration of matters such as:

- The types of engagements performed by the firm, for example, whether the firm performs only compilation engagements or performs a variety of engagements, including audits of financial statements.
- The types of entities for which such engagements are undertaken, for example, the industries in which the entities operate and whether the entities are owner-managed, listed or of significant public interest. An entity may be of significant public interest because it has a large number and wide range of stakeholders or due to the nature and size of its business.
- External factors, such as relevant professional standards and law or regulation.

A24. The quality of professional judgments exercised by the firm is enhanced when personnel making such judgments demonstrate an attitude that includes a questioning mind, critical assessment of information in formulating decisions, and being alert to changes in the nature and circumstances of the firm or its engagements.

#### **Governance and Leadership** (Ref: Para. 23–25)

A25. Law, regulation or other professional standards may prescribe additional matters related to the governance or leadership of the firm, for example, the firm may be required to follow an audit firm governance code that may incorporate specific governance principles and require adherence by the firm to specific provisions.

#### *Culture* (Ref: Para. 23(a), 24(a)(ii))

A26. The firm's culture is an important factor in influencing the behavior of personnel. Relevant ethical requirements ordinarily establish the principles of professional ethics, and are further addressed in the relevant ethical requirements component of this ISQM. Professional values and attitudes may include, for example:

- Professional manner, for example, timeliness, courteousness, respect, accountability, responsiveness, and dependability;

- A commitment to teamwork;
- Maintaining an open mind to new ideas or different perspectives in the professional environment;
- Pursuit of excellence;
- A commitment to continual improvement (e.g., setting expectations beyond the minimum requirements); and
- Social responsibility.

A27. A culture that promotes a commitment to quality is likely to involve clear, consistent, frequent and effective actions, including communications, at all levels within the firm, that emphasize the firm's commitment to quality. The tone at the top and the attitude towards quality, including reinforcing the importance of professional ethics, values and attitudes, are set by the individual(s) assigned ultimate responsibility and accountability for the system of quality management through their personal conduct, communication and actions. The attitude towards quality is further shaped and reinforced by other personnel who are expected to embed or demonstrate the behaviors that reflect the firm's commitment to quality.

A28. The nature and extent of the actions of the individual(s) assigned ultimate responsibility and accountability for the system of quality management in establishing the firm's culture may depend on factors such as the size, structure, geographical dispersion and complexity of the firm. For example, a smaller firm may be able to establish the desired culture through the direct interaction of firm leadership with other personnel. For a larger firm in which personnel are dispersed across many geographical locations, more formal communication may be necessary. Other actions that may be taken to establish the expected behavior of personnel include creating a code of conduct.

*Strategic Decisions and Actions* (Ref: Para. 23(c))

A29. It is important that the firm's strategic decision-making process, which may include establishing a business strategy, takes into consideration how the firm's decisions about financial and operational matters (e.g., the firm's profitability or strategic focus, such as growth of the firm's market share, industry specialization or new service offerings) affect the performance of quality engagements.

*Public Sector Considerations*

A30. In the public sector, although the firm's strategic decisions and actions may be less influenced by matters such as profitability or strategic focus areas, they are nevertheless affected by financial and operational priorities, for example, the allocation of financial resources.

*Organizational Structure* (Ref: Para. 23(d), 24(a)(iii))

A31. The organizational structure of the firm may include operating units, operational processes, divisions or geographical locations and other structures. In some instances, the firm may concentrate or centralize processes or activities in a service delivery center, for example, engagement teams may include human resources from service delivery centers who perform specific tasks that are repetitive or specialized in nature.

A32. How the firm assigns roles, responsibilities and authority within the firm may vary. For example, the leadership structure of a smaller firm may comprise a single managing partner with sole responsibility



for the oversight of the firm. Larger firms may have multiple levels of leadership, such as a chief executive officer (or equivalent) and a managing board of partners (or equivalent), and further levels that reflect the organizational structure of the firm. Some firms may also have an independent governing body that has non-executive oversight of the firm. At a jurisdictional level, law or regulation may impose certain requirements for the firm that affect the leadership and management structure or their assigned responsibilities.

*Resources* (Ref: Para. 23(e))

- A33. The quality objective in this component for resources addresses all categories of resources. The resources component includes quality objectives that address specific aspects of human resources, technological resources and intellectual resources. Financial resources are necessary for obtaining, developing, using and maintaining human resources, technological resources and intellectual resources. The quality objectives and responses in governance and leadership, such as those that address financial and operational priorities, address financial resources.
- A34. The individuals(s) assigned ultimate responsibility and accountability or operational responsibility for the system of quality management are in most cases able to influence the nature and extent of resources that the firm obtains, develops, uses and maintains, and how those resources are allocated or assigned, including the timing of when they are used. The firm's strategic decisions and actions may affect decisions about obtaining, allocating or assigning resources. Paragraph 23(c) requires that the strategic decisions and actions, including the firm's financial and operational priorities, demonstrate a commitment to quality, including not leading to inappropriate decisions about obtaining, allocating or assigning resources for the system of quality management.
- A35. Resource needs may change over time as a result of changes in the nature and circumstances of the firm (e.g., the emergence of new or advanced technology or evolution in the firm's business model) and the engagements performed by the firm. The firm's resource planning involves determining the resources currently required and forecasting the firm's future resource needs. However, given the continual changes in the nature and circumstances of the firm and its engagements, it may not be practicable for the firm to anticipate all possible resource needs or changes to the resource needs and therefore, in most cases, the firm's resource planning includes processes to deal with resource needs that cannot be anticipated as and when they arise.

*Firm Leadership Responsibility and Accountability* (Ref: Para. 23(b), 24(a))

- A36. Paragraph A32 explains the various leadership structures that may exist in a firm. Ordinarily the person with ultimate responsibility and accountability for the system of quality management is the chief executive officer (or equivalent), or the firm's managing partner (e.g., in the case of a smaller firm). However, some firm management structures may share the responsibility and accountability for the system of quality management among the firm's managing board of partners (or equivalent).

*Operational Responsibility* (Ref: Para. 24(a)(iii), 25)

- A37. The individual(s) assigned ultimate responsibility and accountability for the system of quality management is responsible and accountable for the firm achieving the objective of this ISQM. The individual(s) assigned operational responsibility for the system of quality management as a whole is responsible and accountable for the design, implementation and operation of the firm's system of quality management. In some instances, operational responsibility for the matters in paragraph

24(a)(iii) may be assigned to one individual, particularly in the case of a smaller firm. These responsibilities may also be fulfilled by the individual(s) assigned ultimate responsibility and accountability for the system of quality management.

- A38. In some instances, the individual assigned operational responsibility for the system of quality management may further assign specific roles, procedures, tasks or actions to other individuals within the firm. For example, in addition to assigning responsibility for compliance with independence requirements and the monitoring and remediation process, the individual may assign responsibility for technological resources.
- A39. In some circumstances, the firm may establish additional criteria for the eligibility of the individual(s) assigned operational responsibility for the matters set out in paragraph 24(a)(iii).

*Performance Evaluations (Ref: Para. 24(b))*

- A40. Periodic performance evaluations of individual(s) within the firm are a required response to promote the accountability of such individual(s) for their assigned responsibilities. In considering the performance of individuals, the firm may take into account:
- The results of the firm's monitoring activities for aspects of the system of quality management that relate to the responsibility of the individual. For example, the firm may set targets for the individual and measure the results of the firm's monitoring activities against those targets.
  - The actions taken by the individual(s) in response to identified deficiencies that relate to the responsibility of that individual, including the timeliness and effectiveness of such actions.
- A41. A positive performance evaluation may be rewarded through compensation, promotion and other incentives that focus on the individual's commitment to quality, and reinforce accountability. On the other hand, the firm may take corrective actions to address a negative performance evaluation that may affect the firm's achievement of its quality objectives.
- A42. Given the unique position of the individual(s) assigned ultimate responsibility and accountability for the system of quality management, the performance evaluations may be undertaken by an independent non-executive member of the firm's governing body, or a special committee overseen by the firm's governing body, or the firm may engage a service provider to perform the evaluation. In the case of smaller firms, it may not be practicable to perform performance evaluations; however, in such cases, the results of the firm's monitoring activities may provide an indication of the performance of the individual(s).

*Public Sector Considerations*

- A43. In the case of the public sector, it may not be practicable to perform a performance evaluation of the individual assigned ultimate responsibility and accountability for the system of quality management, or to take actions to address the results of the performance evaluation, given the nature of the individual's appointment. Nevertheless, performance evaluations may still be undertaken for other individuals in the firm who are assigned operational responsibility for aspects of the system of quality management.

*Complaints and Allegations (Ref: Para. 24(c))*

- A44. Establishing policies or procedures for dealing with complaints and allegations supports the firm's commitment to quality. Complaints and allegations may originate from within or outside the firm and

they may be made by personnel or external parties, such as clients or others within the firm's network. Complaints and allegations may relate to the failure to perform work in accordance with professional standards and applicable legal and regulatory requirements, or non-compliance with the firm's policies or procedures. A complaint or allegation may indicate that there is a deficiency in the firm's system of quality management, which would be other relevant information considered by the firm as part of its monitoring and remediation process, as required by paragraph 44(e).

- A45. Law, regulation or relevant ethical requirements may establish responsibilities for the firm or its personnel in circumstances when complaints or allegations arise, such as an obligation on the firm or its personnel to report the matter to an authority outside the firm. For example, sections 260 and 360 of the IESBA Code address the approach to be taken by the firm or its personnel in responding to non-compliance or suspected non-compliance with laws or regulations, which may include communications external to the firm that are addressed through the firm's policies or procedures for external communication in paragraph 41(c).
- A46. In identifying an appropriate individual(s) to whom complaints and allegations are to be communicated, the firm may consider whether the individual(s) has:
- The experience, knowledge, time and appropriate authority within the firm needed to assume the role; and
  - A direct line of communication to the individual(s) assigned ultimate responsibility and accountability for the system of quality management.

The firm may use a service provider to facilitate the reporting of complaints and allegations.

- A47. The firm may also identify an individual(s) to be responsible for supervising the investigation of complaints and allegations and may consider:
- The factors described in paragraph A46; and
  - Whether the individual(s) is not otherwise involved in the engagement to which a complaint or allegation pertains or has sufficient objectivity from the area or personnel subject to the investigation.

The individual(s) supervising an investigation may involve legal counsel as necessary. In the case of a smaller firm, it may not be practicable to identify an individual to supervise an investigation of an allegation or complaint who is not involved in the related engagement or area of the investigation. As a result, such firms may use a service provider to carry out the investigation into complaints and allegations, for example, legal counsel or a suitably qualified consultant.

#### **The Firm's Risk Assessment Process** (Ref: Para. 26–31)

- A48. The approach that the firm takes to the risk assessment process may vary according to many factors, including how the firm is structured and organized. For example, the firm's risk assessment process may be centralized (e.g., the quality objectives, quality risks and responses are established centrally for all business units, functions and service lines) or may be decentralized (e.g., the quality objectives, quality risks and responses are established at a business unit, function or service line level, with the outputs combined at the firm level). Although this ISQM is organized by components, the firm's risk assessment process may be undertaken for the system of quality management as a whole.

*Establish Quality Objectives* (Ref: Para. 26)

- A49. The quality objectives that the firm is required to establish are set out in paragraphs 23, 32, 34, 36, 38, 40 and 42. In addition, given the nature and circumstances of the firm and its engagements the firm:
- Is required to establish additional quality objectives beyond those required by this ISQM, when those objectives are necessary to achieve the objective of this ISQM.
  - May decide that more granular quality objectives than those set out in this ISQM are appropriate. Establishing more granular quality objectives may enhance the firm's identification and assessment of quality risks.
- A50. Given the iterative nature of the firm's risk assessment process, the firm may determine that additional quality objectives are necessary to achieve the objective of this ISQM at any stage in the process of establishing quality objectives, identifying and assessing quality risks and designing and implementing responses. The results of the firm's monitoring and remediation process may also highlight that additional quality objectives are necessary to achieve the objective of this ISQM, including in circumstances when it is determined that the system of quality management does not provide reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.
- A51. Although the quality objectives set out in this ISQM are organized by component, an objective in one component may overlap, be related to, support or be supported by a quality objective in another component. For example, the quality objective in information and communication addressing the communication of relevant and reliable information in a timely manner to personnel supports the quality objective in the relevant ethical requirements component addressing the understanding of relevant ethical requirements by the firm, its personnel and others subject to relevant ethical requirements.

*Conditions, Events, Circumstances, Actions or Inactions That May Affect the Achievement of the Quality Objectives* (Ref: Para. 27)

- A52. In understanding the conditions, events, circumstances, actions or inactions that may affect the achievement of its quality objectives, the firm may consider what could go wrong in relation to the matters identified in paragraphs A22–A23 that could affect the achievement of such objectives. Such consideration may also assist with identifying quality risks.

*Identify and Assess Quality Risks* (Ref: Para. 28–29)

- A53. The firm exercises professional judgment in identifying and assessing quality risks. The process for identifying and assessing quality risks may involve a combination of ongoing and periodic risk identification and assessment procedures. In some circumstances, the identification and assessment of quality risks may be undertaken concurrently.
- A54. Under this ISQM, not every quality risk needs to be identified and further assessed. The firm identifies which quality risks need to be further assessed based on a preliminary consideration of the possibility of the quality risks occurring and the effect on the achievement of the quality objectives. Only those quality risks that meet both of the criteria in paragraph 28(a) and (b) need to be identified and further assessed. The further assessment of the quality risks involves a more detailed consideration of the

degree of the likelihood of the quality risks occurring and the significance of the effect of the quality risks on the achievement of the quality objectives.

- A55. There is a reasonable possibility of a quality risk occurring when the likelihood of its occurrence is more than remote.
- A56. The significance of the effect of a quality risk on the achievement of a quality objective(s) is judged in the context of the underlying conditions and events that gave rise to the quality risk, as well as the nature and circumstances of the firm and its engagements, which are further described in paragraphs A22–A23.
- A57. The firm may determine that a quality risk that has a reasonable possibility of occurring does not, on its own, have a significant effect on the achievement of a quality objective(s). However, a quality risk is required to be identified and further assessed in circumstances when the quality risk, in combination with other quality risks that have a reasonable possibility of occurring, have a significant effect on the achievement of a quality objective(s).
- A58. The assessment of identified quality risks need not comprise formal ratings or scores, and may involve taking into consideration:
- The expected frequency of the quality risk occurring.
  - The rate at which the effect of the quality risk would take place, or the amount of time that the firm has to respond to the quality risk.
  - The duration of time of the effect of the quality risk after it has occurred.

*Design and Implement Responses to Assessed Quality Risks (Ref: Para. 19(t), 30)*

- A59. The responses required by this ISQM are set out in paragraphs 24, 25, 33, 35, 37, 41 and 43 and represent responses that are relevant to every firm's system of quality management and are therefore applicable to all firms. However, the responses required by this ISQM alone will not be sufficient to address all of the firm's assessed quality risks, as explained in paragraph 10(c). Accordingly the firm is required to design and implement responses in addition to those required by this ISQM. For example, paragraph A69 identifies additional responses that may be appropriate to address quality risks for relevant ethical requirements.
- A60. The firm exercises professional judgment in designing and implementing responses to address the assessed quality risks. The nature, timing and extent of the responses are affected by the reasons for the assessment given to the assessed quality risks, which includes:
- The likelihood of the assessed quality risk occurring. For example, a more robust response may be needed for an assessed quality risk that has a higher likelihood of occurring.
  - The significance of the effect on the achievement of the quality objectives. For example, a more robust response may be needed for an assessed quality risk that has a more significant effect on the achievement of a quality objective.
  - The conditions, events, circumstances, actions or inactions that give rise to the assessed quality risks. For example, if the assessed quality risk relates specifically to engagements performed for a category of entities (e.g., audits of financial statements of listed entities), the responses may require specific actions for entities in that category, rather than all engagements performed by the firm.

- A61. The nature and circumstances of the firm and its engagements affect the reasons for the assessment given to the assessed quality risks, and the nature, timing and extent of the responses designed and implemented to address the assessed quality risks. For example, in demonstrating a commitment to quality through their actions and behaviors, as required by paragraph 24(a)(ii), leadership of a smaller firm may engage in direct and frequent interactions with personnel throughout the firm. However, in the case of a larger firm, frequent and direct interactions by leadership with all personnel may not be practicable and therefore the actions taken to demonstrate a commitment to quality may involve multiple actions, including establishing firm values in a code of conduct that all personnel are required to comply with and a series of formal communications from firm leadership that emphasize the importance of quality.
- A62. The responses designed and implemented by the firm may operate at the firm level or engagement level, or there may be a combination of responsibilities for actions to be taken at the firm and engagement level in order for a response to operate as designed. For example, the firm may appoint suitably qualified and experienced personnel to provide technical advice to engagement teams and, in doing so, may prescribe specific matters for which consultation by the engagement team is required. The engagement team may have a responsibility to identify when such matters occur and to initiate such consultation as required by the firm's policies or procedures. Communicating to engagement teams about their responsibilities for the implementation of the responses is therefore important for the functioning of the system of quality management, and is a response required by paragraph 41(b).
- A63. The need for formally documented policies or procedures may be greater for firms that have many personnel or that are geographically dispersed, in order to achieve consistency across the firm.
- A64. In some cases, the response designed and implemented by the firm may address multiple assessed quality risks across multiple components of the system of quality management. Furthermore, the responses designed and implemented to address an assessed quality risk in one component may affect the assessed quality risks and responses of another component. For example, engaging a service provider to manage all aspects of the firm's IT environment may create new quality risks for relevant ethical requirements (e.g., the service provider may have access to confidential information).

*Changes in the Nature and Circumstances of the Firm or Its Engagements (Ref: Para. 31)*

- A65. In some circumstances, changes in the nature and circumstances of the firm's engagements may affect the design, implementation and operation of the system of quality management. For example, the firm may accept an engagement to perform an audit of financial statements for an entity involved in an industry for which the firm has not previously performed audit engagements that may create new quality risks (e.g., personnel do not have the knowledge or experience relevant to the engagement).
- A66. Quality objectives, quality risks or responses may also need to be modified as a result of:
- Changes that affect specific components of the system of quality management, for example, changes in the firm's resources.
  - Information from the firm's monitoring and remediation, including identified deficiencies from monitoring activities, external inspections or other relevant information.

**Relevant Ethical Requirements** (Ref: Para. 32–33)

A67. The IESBA Code sets out the fundamental principles of ethics that establish the standard of behavior expected of a professional accountant and establishes the International Independence Standards. The fundamental principles are integrity, objectivity, professional competence and due care, confidentiality and professional behavior. The IESBA Code also specifies the approach that a professional accountant is required to apply to comply with the fundamental principles and the International Independence Standards and addresses specific topics relevant to complying with the fundamental principles. Law or regulation in a jurisdiction may also contain provisions addressing ethical requirements, including independence, for example, privacy laws affecting the confidentiality of information.

A68. In some cases, the firm may determine that it is appropriate to design and implement responses that are more specific than the provisions of relevant ethical requirements. For example, having regard to the nature and circumstances of the firm and its engagements, a firm may:

- Prohibit the acceptance of gifts and hospitality from a client, even if the value is trivial and inconsequential.
- Set rotation periods for the engagement partner and other senior personnel for all engagements performed by the firm, including other assurance or related services engagements.

A69. Other components include responses that may affect or relate to the relevant ethical requirements component. For example, the following are examples of responses for information and communication and resources that may address assessed quality risks for relevant ethical requirements:

- Communicating the independence requirements to all personnel and others subject to independence requirements, as applicable.
- Providing training for personnel on relevant ethical requirements.
- Establishing manuals and guides (i.e., intellectual resources) containing the provisions of the relevant ethical requirements and guidance on how they are applied in the circumstances of the firm and the engagements it performs.
- Assigning personnel (i.e., human resources) to manage and monitor compliance with relevant ethical requirements or to provide consultation on matters related to relevant ethical requirements.
- Establishing policies or procedures for personnel to communicate relevant information to appropriate parties within the firm or to the engagement partner related to:
  - Personal or firm situations that may create threats to independence, for example, financial interests, loans, employment relationships or personal appointments.
  - Client engagements, including non-assurance engagements. For example, this may include the scope of services, fees or information about long association.
  - Business relationships.
  - Any breaches of the relevant ethical requirements, including those related to independence.

- Establishing an information system, including through IT applications (i.e., technological resources), to monitor compliance with relevant ethical requirements, including recording and maintaining information about independence.

Furthermore, the individual in the firm assigned operational responsibility for compliance with independence requirements is ordinarily responsible for the oversight of all matters related to independence, including the policies or procedures addressing communication of breaches of independence requirements and determining that appropriate actions have been taken to address the causes and consequences of the breach.

A70. Various provisions of the relevant ethical requirements may apply only to personnel and not the firm itself. For example, Part 2 of the IESBA Code applies to individuals who are professional accountants in public practice when performing professional activities pursuant to their relationship with the firm. The firm's system of quality management may need to address personnel's compliance with such relevant ethical requirements, for example, the firm may need to establish policies or procedures to facilitate personnel's compliance with Part 2 of the IESBA Code (e.g., policies or procedures addressing section 260 of the IESBA Code regarding non-compliance with laws and regulations).

A71. The applicability of the relevant ethical requirements to others (i.e., the network, network firms, personnel in the network or network firms, or service providers) depends on whether those requirements contain specific provisions addressing others, and how the firm uses others in its system of quality management. For example:

- Relevant ethical requirements may include requirements for independence that apply to network firms or employees of network firms.
- The definition of engagement team under relevant ethical requirement may include any individuals engaged by the firm who perform assurance procedures on the engagement (e.g., a service provider engaged to attend a physical inventory count at a remote location). Accordingly, any requirements of the relevant ethical requirements that apply to the engagement team may also be relevant to such individuals.
- The principle of confidentiality may apply to a network, network firm or service provider, given that they may have access to client information obtained by the firm.

A72. Relevant ethical requirements may contain provisions regarding the identification and evaluation of threats and how they should be addressed. For example, the IESBA Code provides a conceptual framework for this purpose and, in applying the conceptual framework, requires that the firm use the reasonable and informed third party test.

A73. The policies or procedures addressing breaches of the relevant ethical requirements, including those related to independence, may address matters such as:

- The communication of breaches of the relevant ethical requirements to appropriate individual(s) within the firm;
- The evaluation of the significance of a breach and its effect on compliance with relevant ethical requirements;
- The actions to be taken to satisfactorily address the consequences of a breach, including that such actions be taken as soon as practicable;
- Determining whether to report a breach to external parties; and



- Determining the appropriate actions to be taken in relation to the individual(s) responsible for the breach.

A74. Relevant ethical requirements may specify how the firm is required to respond to a breach. The IESBA Code sets out requirements for the firm in the event of a breach of the IESBA Code and includes specific requirements addressing breaches of the International Independence Standards, which includes requirements for communication with external parties.

#### *Public Sector Considerations*

A75. Statutory measures may provide safeguards for the independence of public sector auditors. However, threats to independence may still exist regardless of any statutory measures designed to protect the firm's independence that will require an appropriate response by the organization.

#### **Acceptance and Continuance of Client Relationships and Specific Engagements** (Ref: Para. 34–35)

A76. Other components include responses that may affect or relate to the acceptance and continuance of client relationships and specific engagements component. For example:

- The information necessary to support the firm's decisions about the acceptance and continuance of client relationships and specific engagements is identified, captured, processed and maintained through the information and communication component, and may include intellectual resources such as databases of client information or access to external information databases.
- The firm may use technological resources in the form of IT applications to facilitate the approval of client relationships or specific engagements at appropriate levels within the firm.
- Governance and leadership addresses the responsibility of the firm with respect to appropriate resource planning and obtaining, allocating or assigning resources.

#### *The Nature and Circumstances of the Engagement and the Integrity and Ethical Values of the Client* (Ref: Para. 34(a))

A77. The information obtained about the nature and circumstances of the engagement may include:

- The industry of the entity for which the engagement is being undertaken and relevant regulatory factors;
- The nature of the entity, for example, its operations, organizational structure, ownership and governance, its business model and how it is financed; and
- The nature of the underlying subject matter and the criteria to be applied in the preparation of the subject matter information, for example, in the case of integrated reporting, the underlying subject matter may include social, environmental and health and safety information and the criteria may be performance measures established by a recognized body of experts.

A78. In some circumstances the firm may establish policies or procedures that specify, or prohibit, the types of engagements that may be performed by the firm, for example, the firm may prohibit the performance of assurance engagements over a certain subject matter. The policies or procedures may also prohibit the performance of engagements for certain types of entities, for example, the firm may prohibit the performance of engagements in certain industries.

A79. The information obtained to support the firm's judgments about the integrity and ethical values of the client may include the identity and business reputation of the client's principal owners, key management, and those charged with its governance. The nature and extent of information obtained may depend on factors such as:

- The nature of the entity for which the engagement is being performed, including the complexity of its ownership and management structure.
- The nature of the client's operations, including its business practices.
- Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.
- Whether the client is aggressively concerned with maintaining the firm's fees as low as possible.
- Indications of a client-imposed limitation in the scope of work.
- Indications that the client might be involved in money laundering or other criminal activities.
- The reasons for the proposed appointment of the firm and non-reappointment of the previous firm.
- The identity and business reputation of related parties.

A80. The firm may obtain the information from a variety of internal and external sources, for example:

- In the case of an existing client, consideration of matters that have arisen during the current or previous engagements, if applicable, or inquiry of other personnel who have performed other engagements for the client.
- In the case of a new client, inquiry of existing or previous providers of professional accountancy services to the client, in accordance with relevant ethical requirements.
- Discussions with other third parties, such as bankers, legal counsel and industry peers.
- Background searches of relevant databases (which may be intellectual resources). In some cases, the firm may use a service provider to perform the background search.

A81. Information that is obtained during the firm's acceptance and continuance process about the nature and circumstances of the engagement and the integrity and ethical values of the client's management, and, when appropriate, those charged with governance is in most cases relevant to the engagement team when planning and performing the engagement. Professional standards may specifically require the engagement team to obtain or consider such information. For example, ISA 220 (Revised)<sup>27</sup> requires the engagement partner to take into account information obtained in the acceptance and continuance process in planning and performing the audit engagement in accordance with the ISAs and complying with the requirements of ISA 220 (Revised).

A82. Professional standards or legal and regulatory requirements may include specific provisions that need to be addressed before accepting or continuing a client relationship or specific engagement and may also require the firm to make inquiries of an existing or predecessor firm when accepting an

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<sup>27</sup> Proposed ISA 220 (Revised), paragraph 21

engagement. For example, when there has been a change of auditors, ISA 300<sup>28</sup> requires the auditor, prior to starting an initial audit, to communicate with the predecessor auditor in compliance with relevant ethical requirements. The IESBA Code also includes requirements for the consideration of conflicts of interests in accepting or continuing a client relationship or specific engagement and communication with the existing or predecessor firm when accepting an engagement that is an audit or review of financial statements.

*The Firm's Ability to Perform Engagements (Ref: Para. 34(b))*

A83. The consideration of whether the firm is able to perform engagements in accordance with professional standards and applicable legal and regulatory requirements includes determining that the firm, its personnel and others are able fulfill their responsibilities in relation to the relevant ethical requirements.

A84. The judgments about whether the firm has the resources to perform the engagement may involve reviewing the specific circumstances of the engagement and considering whether the firm has the resources to perform the engagement within the reporting deadline, including whether there are:

- Human resources with the appropriate competence and capabilities, including sufficient time, to perform the engagement. This includes:
  - Personnel to direct and supervise the engagement and take overall responsibility; and
  - Human resources with knowledge of the relevant industry or the underlying subject matter or criteria to be applied in the preparation of the subject matter information and experience with relevant regulatory or reporting requirements.
- Experts that are available, if needed.
- Engagement quality reviewers who meet the eligibility requirements in ISQM 2, if applicable.
- Technological resources, for example, IT applications that enable the engagement team to perform procedures on the entity's data.
- Intellectual resources, for example, a methodology, industry or subject matter-specific guides, or access to information sources.

*The Firm's Financial and Operational Priorities (Ref: Para. 34(c))*

A85. Financial priorities may focus on the profitability of the firm, and fees obtained for the performance of engagements have an effect on the firm's financial resources. Operational priorities may include strategic focus areas, such as growth of the firm's market share, industry specialization or new service offerings. There may be circumstances when the firm is satisfied with the fee quoted for an engagement but, notwithstanding the firm's operational and financial priorities, it is not appropriate for the firm to accept or continue the engagement or client relationship (e.g., when the client lacks appropriate integrity and ethical values).

A86. There may be other circumstances when the fee quoted for an engagement is not sufficient given the nature and circumstances of the engagement, and it may diminish the firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements. The IESBA Code addresses fees and other types of remuneration, including

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<sup>28</sup> ISA 300, *Planning an Audit of Financial Statements*, paragraph 13(b)

circumstances that may create a threat to compliance with the fundamental principle of professional competence and due care if the fee quoted for an engagement is too low.

*Information That Becomes Known Subsequent to Accepting or Continuing a Client Relationship or Specific Engagement* (Ref: Para. 34(d))

A87. Information that becomes known subsequent to accepting or continuing a client relationship or specific engagement may:

- Have existed at the time of the firm's decision to accept or continue the client relationship or specific engagement and the firm was not aware of such information; or
- Relate to new information that has arisen since the decision to accept or continue the client relationship or specific engagement.

The information may come to the attention of the firm in a variety of ways, including through the engagement partner or engagement team. For example, ISA 220 (Revised)<sup>29</sup> requires the engagement partner to communicate information to the firm that the engagement partner obtains that may have caused the firm to decline the audit engagement had that information been known by the firm prior to accepting or continuing the client relationship or specific engagement.

A88. The firm's response to address circumstances when information becomes known subsequent to accepting or continuing a client relationship or specific engagement that may have affected the firm's decision to accept or continue a client relationship or specific engagement may include policies or procedures that set out the actions to be taken, including:

- Undertaking appropriate consultation within the firm or with legal counsel.
- Considering whether there is a professional, legal or regulatory requirement for the firm to continue the engagement.
- Discussing with the appropriate level of the client's management and with those charged with governance or the engaging party the appropriate action that the firm might take based on the relevant facts and circumstances, and when it is determined that withdrawal is an appropriate action, informing them of this decision and the reasons for the withdrawal.
- If the firm withdraws from the engagement, considering whether there is a professional, legal or regulatory requirement for the firm to report the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities.
- If the firm does not withdraw from the engagement, considering the effect of the information on the performance of the engagement and the additional actions to be taken by the firm or the engagement partner in managing quality at the engagement level (e.g., assigning more experienced personnel to the engagement, requiring an engagement quality review or increasing the extent and frequency of the engagement partner's direction and supervision of engagement team members and review of their work).

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<sup>29</sup> Proposed ISA 220 (Revised), paragraph 22

*Circumstances When the Firm is Obligated to Accept or Continue a Client Relationship or Specific Engagement* (Ref: Para. 35)

- A89. There may be circumstances when the firm is obligated to accept or continue a client relationship or specific engagement. For example, jurisdictional law or regulation may impose an obligation on the firm to accept or continue a client engagement, or in the case of the public sector, the firm may be appointed through statutory provisions. In such circumstances, when the firm becomes aware of information that would otherwise have caused the firm to decline or discontinue the engagement, the firm may design and implement additional responses to address the assessed quality risk(s) arising from the performance of such engagements. For example, the firm may assign more experienced personnel to the engagement or may require that an engagement quality review be performed in respect of the engagement. There may also be actions at the engagement level to manage quality when performing such engagements, for example, increasing the extent and frequency of the engagement partner's direction and supervision of engagement team members and review of their work.
- A90. In some circumstances, a threat to the firm's integrity may arise as a result of being associated with the subject matter of the engagement. Relevant ethical requirements may include requirements addressing circumstances when the firm becomes associated with information that is false or misleading. For example, the IESBA Code contains requirements addressing circumstances when the professional accountant becomes associated with information that contains a materially false or misleading statement, contains statements that have been provided recklessly or omits or obscures required information where such omission or obscurity would be misleading.

**Engagement Performance** (Ref: Para. 36–37)

- A91. ISA 220 (Revised)<sup>30</sup> requires the engagement partner to take overall responsibility for managing and achieving quality on the audit engagement.

*Direction, Supervision and Review* (Ref: Para. 36(a)(ii), 37(a))

- A92. The firm's policies or procedures addressing engagement supervision may include responsibilities for:
- Tracking the progress of the engagement;
  - Considering the competence and capabilities 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 matters arising during the engagement, considering their significance and modifying the planned approach appropriately; and
  - Identifying matters for consultation or consideration by more experienced engagement team members during the engagement.
- A93. The policies or procedures addressing the review of the work of engagement teams may address matters such as the reviewer's consideration of whether:

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<sup>30</sup> Proposed ISA 220 (Revised), paragraph 11

- The work has been performed in accordance with professional standards and applicable legal and regulatory requirements;
- Significant matters have been raised for further consideration;
- Appropriate consultations have been undertaken and the resulting conclusions have been documented and implemented;
- There is a need to revise the nature, timing and extent of work performed;
- The work performed supports the conclusions reached and is appropriately documented;
- The evidence obtained for an assurance engagement is sufficient and appropriate to support the report; and
- The objectives of the engagement procedures have been achieved.

*Judgments and Conclusions* (Ref: Para. 36(b))

- A94. The system of quality management creates an environment that supports engagement teams in making informed decisions about the courses of action that are appropriate given the nature and circumstances of the engagement. For example, the responses designed and implemented by the firm to establish a culture that promotes a commitment to quality or the responses addressing the hiring, development, retention and assignment of personnel with the competence and capabilities to perform engagements are important in supporting the engagement team in exercising appropriate professional judgment and, when applicable to the type of engagement, professional skepticism.
- A95. The firm's policies or procedures for consultation and differences of opinion and the performance of engagement quality reviews may also address assessed quality risks related to exercising appropriate professional judgment and, when applicable to the type of engagement, professional skepticism in planning and performing engagements. The firm may also design and implement other types of responses, including other forms of engagement reviews that are not engagement quality reviews. For example, for audits of financial statements, the firm's responses may include reviews of the engagement team's procedures on significant risks or reviews of certain matters by individuals within the firm who have specialized technical expertise. In some cases, these other types of engagement reviews may be undertaken in addition to an engagement quality review.
- A96. Professional skepticism supports the quality of judgments made on the engagement and, through these judgments, the overall effectiveness of the engagement team in performing the engagement. Other pronouncements of the IAASB may address the exercise of professional judgment or professional skepticism at the engagement level. For example, ISA 220 (Revised)<sup>31</sup> explains the impediments to the exercise of professional skepticism at the engagement level and actions that the engagement partner may take to deal with such impediments.
- A97. In performing related services engagements, a practitioner is not required to gather evidence to express an opinion or conclusion on the information. However, the practitioner may form conclusions related to the performance of the engagement, for example, in a compilation engagement the practitioner may conclude that the compiled financial information is misleading and be required to take the appropriate actions set out in ISRS 4410 (Revised).<sup>32</sup>

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<sup>31</sup> Proposed ISA 220 (Revised), paragraphs A27–A29

<sup>32</sup> International Standard on Related Services (ISRS) 4410 (Revised), *Compilation Engagements*, paragraphs 34–36

*Consultation* (Ref: Para. 37(c))

- A98. Consultation typically involves a discussion at the appropriate professional level, with individuals within or outside the firm who have specialized expertise, on difficult or contentious matters. While the firm establishes policies or procedures regarding the matters on which consultation is required, the engagement team may identify other matters that require consultation.
- A99. In considering its resource needs, the firm may consider the resources needed to enable consultation, for example, appropriate access to intellectual resources to facilitate research and personnel with the competence and capabilities to provide consultations. In some instances, such as a smaller firm, human resources to support consultation may only be available externally, for example, other firms, professional and regulatory bodies, or commercial organizations that provide such services. In such cases, paragraphs 64–65 apply.

*Differences of Opinion* (Ref: Para. 37(d))

- A100. The policies or procedures addressing differences of opinion may be established in a manner that encourages identification of differences of opinion at an early stage. Procedures to resolve such differences may include consulting with another practitioner or firm, or a professional or regulatory body.

*Engagements Subject to an Engagement Quality Review* (Ref: Para. 37(e))

- A101. The categories of engagements for which an engagement quality review is required are not mutually exclusive. For example, many listed entities may be considered to be of significant public interest based on the characteristics described in paragraph A102. In addition, law or regulation may require engagement quality reviews to be performed for certain types of entities (e.g., entities with public accountability as defined in certain jurisdictions), or may include different criteria or characteristics that firms may use in determining whether an entity is of significant public interest.
- A102. In determining whether an entity is of significant public interest, the firm may take into account, for example, whether the entity has a large number and wide range of stakeholders, and the nature and size of the business. The firm also may consider the relative significance of factors such as these in the context of the jurisdiction or region in which the entity operates. Entities that the firm determines to be of significant public interest may include entities such as financial institutions (e.g. certain banks, insurance companies, and pension funds), and other entities such as certain not-for-profit organizations.
- A103. Law or regulation may require an engagement quality review to be performed, for example, for audit engagements for entities that:
- Are characterized as public interest entities;
  - Operate in the public sector or which are recipients of government funding;
  - Operate in certain industries (e.g., financial institutions such as banks, insurance companies and pension funds);
  - Meet a specified asset threshold; or
  - Are under the management of a court or judicial process (e.g., liquidation).

A104. Audits or other engagements for which the firm may determine that an engagement quality review is an appropriate response to assessed quality risks may include, for example, engagements:

- That involve a high level of complexity or judgment, such as:
  - An audit of financial statements for an entity operating in an industry that typically has accounting estimates with a high degree of estimation uncertainty (e.g., certain large financial institutions or mining entities), or for which uncertainties exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.
  - An assurance engagement that requires specialized skills and knowledge in measuring or evaluating the underlying subject matter against the applicable criteria (e.g., a greenhouse gas statement in which there are significant uncertainties associated with the quantities reported therein).
- Where issues have been encountered on the engagement, for example, audit engagements with recurring internal or external inspection findings, unremediated deficiencies in internal control, or a material restatement of comparative information in the financial statements.
- For entities in emerging industries or that involve emerging technologies, or for which the firm has no previous experience.
- For which unusual circumstances are identified during the firm's acceptance and continuance of client relationships and specific engagements (e.g., a new client that had a disagreement with its previous auditor or assurance practitioner).
- That involve reporting on financial or non-financial information that is expected to be included in a regulatory filing, or that may involve a higher degree of judgment, such as pro forma financial information to be included in a prospectus.
- For entities for which concerns were expressed in communications from securities or prudential regulators.

A105. In some cases, there may be no engagements for which an engagement quality review is required to be performed (e.g., when a firm does not perform audits of listed entities or entities of significant public interest and other responses to assessed quality risks are determined by the firm to be appropriate).

#### Considerations Specific to Public Sector Audit Organizations

A106. Public sector entities may be of significant public interest due to their size and complexity, the range of their stakeholders and the nature of the services they provide. Factors to consider in determining whether a public sector entity is of significant public interest may include whether the entity is a national, regional or local government, or whether an opinion is being expressed on the entire entity or only certain units. Other factors to consider may include whether the entity is a corporation that is state owned or in which the state has a controlling stake or a stake with significant influence. Larger public sector entities may be determined to be of significant public interest due to their social or economic influence on the community or region in which the entity operates.

A107. The firm may determine that an engagement quality review is an appropriate response to a quality risk for engagements in the public sector for which law or regulation establishes additional reporting requirements (e.g., a separate report on instances of non-compliance with law or regulation to the



legislature or other governing body or communicating such instances in the auditor's report on the financial statements).

*Engagement Documentation* (Ref: Para. 37(f))

A108. Law or regulation may prescribe the time limits by which the assembly of final engagement files for specific types of engagements is to be completed. Where no such time limits are prescribed in law or regulation, the firm ordinarily establishes an appropriate time limit. In the case of an audit of financial statements, for example, such a time limit would ordinarily not be more than 60 days after the date of the auditor's report.

A109. The retention and maintenance of engagement documentation includes managing the safe custody, integrity, accessibility or retrievability of the underlying data. The retention and maintenance of engagement documentation may involve the use of IT applications. The integrity of engagement documentation may be compromised if it is altered, supplemented or deleted without the appropriate authorization to do so, or if it is permanently lost or damaged. The firm's responses may therefore include actions to prevent unauthorized access and create audit trails that indicate access and changes to engagement documentation.

A110. Relevant ethical requirements generally include provisions relating to confidentiality of client information, unless specific client authority has been given to disclose information, or there is a legal or professional duty or right to disclose the information. Specific law or regulation may impose additional obligations on personnel to maintain client confidentiality, particularly where data of a personal nature is concerned. Accordingly, the firm's responses for relevant ethical requirements may include responses for the retention and maintenance of engagement documentation. The firm's responses to address the confidentiality of client information may need to address all possible locations of client information, including engagement documentation, emails, firm servers or hard copy.

A111. Law or regulation may prescribe the retention period for engagement documentation, or there may be generally accepted retention periods. If the retention periods are not prescribed in law or regulation, the firm may, in determining an appropriate retention period, consider the nature of the engagements performed by the firm and the firm's circumstances, for example, whether the engagement documentation is needed to provide a record of matters of continuing significance to future engagements. In the case of audits of financial statements, the retention period would ordinarily be no shorter than five years from the date of the auditor's report, or, if later, the date of the auditor's report on the group financial statements, when applicable.

A112. Unless otherwise specified by law or regulation, engagement documentation is the property of the firm. The firm may, at its discretion, make portions of, or extracts from, engagement documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the firm or its personnel.

**Resources** (Ref: Para. 38–39)

A113. Resources for the purposes of the resources component include:

- Human resources.
- Technological resources, for example, IT applications.
- Intellectual resources, for example, written policies or procedures, a methodology or guides.

Financial resources are also relevant to the system of quality management because they are necessary for obtaining, developing and maintaining the firm's human resources, technological resources and intellectual resources. The governance and leadership component addresses appropriate resource planning for all resources. Given the nature of financial resources, the quality objectives and responses in governance and leadership, such as those that address financial and operational priorities, address financial resources. This component addresses specific aspects of human resources, technological resources and intellectual resources.

A114. Resources are pervasive to all components of the system of quality management and therefore the firm's responses for resources will address assessed quality risks specific to resources, as well as assessed quality risks for other components. Such responses may be designed and implemented individually for each component, or they may be designed and implemented for all components holistically.

A115. Resources may be internal to the firm, or may be obtained externally from a network, network firm or service provider. In such circumstances, in addition to complying with the requirements for resources set out in this component, the firm is also required to comply with paragraphs 58–63 addressing network requirements or network services or paragraphs 64–65 addressing the use of resources from a service provider.

A116. Other components include responses that may affect or relate to the resources component. For example, the information necessary to facilitate the appropriate assignment of personnel or the evaluation of personnel is identified, captured, processed and maintained through the information and communication component.

*Human Resources* (Ref: Para. 38(a)–38(d))

A117. Competence is the ability of the individual to perform a role to a defined standard and goes beyond knowledge of principles, standards, concepts, facts, and procedures; it is the integration and application of technical competence, professional skills, and professional ethics, values and attitudes. Competence can be developed through a variety of methods, including professional education, continuing professional development, training, work experience or coaching of less experienced engagement team members by more experienced engagement team members.

A118. Professional standards, law or regulation may establish requirements addressing competence and capabilities. For example, law or regulation of a jurisdiction may establish requirements for the professional licensing of engagement partners, including requirements regarding their professional education and continuing professional development.

A119. The firm's responses that relate to the hiring, development and retention of personnel may include:

- Recruitment strategies that focus on selecting individuals who have the ability to develop the competence necessary to consistently perform quality engagements or activities in relation to the operation of the system of quality management.
- Training programs, which may form part of the firm's intellectual resources, to develop personnel's competence to enable them to perform their roles and responsibilities.
- Policies addressing the continuing professional development of personnel, including personnel's responsibility to maintain an appropriate level of continuing professional development, and training resources and other assistance provided by the firm.

- Evaluation mechanisms that establish competency areas and other performance measures, and facilitate the evaluation of personnel at appropriate intervals.
- Compensation, promotion and other incentives, appropriate to the nature and circumstances of the firm, for all personnel, including engagement partners, the individuals assigned ultimate responsibility and accountability for the firm's system of quality management, and the individual(s) assigned operational responsibility the firm's system of quality management or other aspects of the system of quality management.

A120. Human resources assigned to engagements or other roles may include personnel in a service delivery center, human resources engaged by the firm (i.e., a service provider) or human resources from a network or network firm.

A121. Timely evaluations and feedback help support and promote the continual development of the competence of personnel. Less formal methods of evaluation and feedback may be used, for example, in the case of smaller firms with fewer personnel.

A122. Evaluations of personnel may be used by the firm in determining the compensation, promotion, or other incentives. In some circumstances, simple or informal incentives that are not based on monetary rewards may be appropriate.

A123. The firm may take action for personnel who demonstrate actions or behaviors that negatively affect quality, including failing to demonstrate a commitment to quality, develop and maintain the competence to perform their role or implement the firm's responses as designed (e.g., an individual breaches the firm's policies or procedures related to independence). The consequences or actions taken by the firm may depend on the severity of the failure and the frequency of occurrence and may include, for example:

- Training or other professional development;
- Considering the effect of the matter on the evaluation, compensation, promotion or other incentives of the individual(s); or
- Taking disciplinary action against the individual(s), if appropriate, depending on the severity of the failure and the frequency of occurrence.

*Technological Resources* (Ref: Para. 38(e))

A124. Technological resources, which are typically IT applications, form part of the firm's IT environment. The firm's IT environment also includes the supporting IT infrastructure and the IT processes and human resources involved in those processes that the firm uses in the operation of its system of quality management:

- An IT application is a program or a set of programs that is designed to perform a specific function directly for the user or, in some cases, for another application program.
- The IT infrastructure is comprised of the network, operating systems, and databases and their related hardware and software.
- The IT processes are the firm's processes to manage access to the IT environment, manage program changes or changes to the IT environment and manage IT operations, which includes monitoring the IT environment.

A125. An IT application, IT infrastructure or IT process may serve multiple purposes within the firm and some of the purposes may be unrelated to the system of quality management. Only IT applications, IT infrastructure or IT processes that support the firm's system of quality management are relevant for the purposes of this ISQM.

A126. In some cases, the network may require the firm to use an IT application, the firm may choose to use an IT application provided by the network, or the firm may purchase an IT application from a service provider. The firm may also use the network or a service provider to manage certain aspects of the IT processes.

A127. Paragraph 40(a) addresses the firm's responsibility to establish an information system that supports the system of quality management, which may include the use of IT elements and records in the form of digital information. The firm may also use certain IT applications to enable the operation of various aspects of its system of quality management, for example, IT applications used to monitor compliance with relevant ethical requirements and record and maintain information about independence. Other IT applications may be implemented by the firm for use by engagement teams in performing engagements, for example, the firm may mandate the use of an IT application that facilitates the documentation of work performed or the firm may offer an IT application to perform analyses of the client's information that engagement teams may choose to use.

A128. The IT environment for a larger firm may be comprised of customized or integrated IT applications, with dedicated human resources to manage the IT infrastructure and IT processes. The IT environment for smaller firms may comprise IT applications that are commercial software, and the IT processes may involve authorizing access to the IT applications and processing updates to the IT applications.

A129. The use of IT applications or other aspects in the IT environment may give rise to quality risks, for example:

- Inappropriate reliance on IT applications that are inaccurately processing data, processing inaccurate data, or both.
- Unauthorized access to data that may result in breaches in confidentiality of information contained in the data, destruction of data or improper changes to data.
- Potential loss of data or inability to access data or IT applications as required.
- Unauthorized changes to IT applications or other aspects of the IT environment.
- Failure to make necessary changes to IT applications or other aspects of the IT environment.

The nature and significance of these quality risks may vary based on whether, and the extent to which, the firm relies on IT, including automated controls, to enable the design, implementation and operation of the system of quality management. General IT controls may be part of the responses designed and implemented by the firm to address quality risks identified and assessed by the firm.

A130. When implementing an IT application, particularly a customized IT application that has been developed specifically for the firm, it is necessary for the firm to determine that the IT application operates appropriately. This determination may involve consideration of whether:

- The data inputs are appropriate and confidentiality of the data is preserved.
- The IT application operates as designed and achieves the purpose for which it is intended.

- The outputs of the IT application achieve the purpose for which they will be used.
- It is clear how users are required to interact with and use the IT application and users have appropriate support.
- The general IT controls necessary to support the IT application's continued operation as designed are appropriate.

The firm may specifically prohibit the use of IT applications or features of IT applications, until such time that it has been determined that they operate appropriately and have been approved for use by the firm.

A131. Engagement teams may need training on how to use the IT applications appropriately. Furthermore, for certain IT applications, specialized skills may be needed to utilize the IT application effectively and the firm may need to specify procedures that set out how the engagement team operates the IT application. For example, in some instances the firm's IT application for the performance of engagements may require that the engagement team complete certain information about the client and the circumstances of the engagement in order to generate an appropriate engagement file template for the circumstances of the engagement.

*Intellectual Resources (Ref: Para. 38(f))*

A132. Intellectual resources include the information the firm uses to promote consistency in the performance of engagements, for example, written policies or procedures, a methodology, industry or subject matter-specific guides, accounting guides, standardized documentation or access to information sources (e.g., subscriptions to websites that provide in-depth information about entities or other information that is typically used in the performance of engagements).

A133. The intellectual resources may be made available to personnel through technological resources, for example, the firm's audit methodology may be embedded in the audit IT application that facilitates the planning and performance of the engagement. The firm may also need human resources to develop, implement and maintain its intellectual resources. Intellectual resources may also be dependent on relevant and reliable information that is identified, captured, processed and maintained through the firm's information and communication component.

*Personnel's Use of Technological and Intellectual Resources (Ref: Para. 38(g))*

A134. The firm may establish policies or procedures regarding the use of the firm's technological and intellectual resources. Such policies or procedures may:

- Require the use of certain IT applications or intellectual resources in performing engagements, for example, engagement teams may be required to use the firm's methodology when performing the engagement. They may also be required to use IT applications that facilitate the performance of the engagement and the archival of the engagement file.
- Specify the qualifications or experience of personnel that are needed to use the IT application, for example, the firm may specify the qualifications or expertise needed to use an IT application for the performance of automated techniques and to interpret the results.
- Set out how the technological or intellectual resources are to be used.

### **Information and Communication** (Ref: Para. 40–41)

A135. Obtaining, generating or communicating information is generally an ongoing process that involves all personnel and encompasses the dissemination of information within the firm and externally. Information and communication is pervasive to all components of the system of quality management and therefore the firm's responses for information and communication address assessed quality risks specific to information and communication, as well as assessed quality risks for the other components. Such responses may be designed and implemented individually for each component, or for all components holistically. Paragraphs A51, A69, A76 and A116 explain and provide examples of how the information and communication component supports the design, implementation and operation of the other components of the system of quality management.

#### *The Firm's Information System* (Ref: Para. 40(a))

A136. Reliable information includes information that is accurate, complete, timely and valid to enable the proper functioning of the firm's system of quality management and to support decisions regarding the system of quality management.

A137. The information system in smaller firms is likely to be less sophisticated than in larger firms and involve a less complex IT environment.

A138. The information system may include the use of manual or IT elements, which affect the manner in which information is identified, captured, processed, maintained and communicated. The procedures to identify, capture, process, maintain and communicate information may be enforced through IT applications, and in some cases may be embedded within the firm's responses for other components. For example, the firm's responses for monitoring and remediation may define how information from the results of the firm's monitoring activities is captured, processed, maintained and communicated. In addition, digital records may replace or supplement physical records. For example, the firm may use an IT application to obtain a documented confirmation of compliance with independence requirements from personnel.

#### *Communication Within the Firm* (Ref: Para. 40(b)–(d), 41(a)–(b))

A139. The firm and its personnel share relevant information to enable the proper functioning of the firm's system of quality management. For example:

- The firm communicates information to engagement teams, such as information that is obtained during the firm's acceptance and continuance process that is relevant to engagement teams in planning and performing engagements.
- Engagement teams communicate information to the firm, for example, information about:
  - The client obtained during the performance of an engagement that may have caused the firm to decline the client relationship or specific engagement had that information been known prior to accepting or continuing the client relationship or specific engagement.
  - The operation of the firm's responses to assessed quality risks (e.g., concerns about the firm's processes for assigning personnel to engagements).

In some cases, the information communicated by the engagement team may indicate a deficiency in the firm's system of quality management.

- Personnel performing activities within the firm's system of quality management share information. For example, the individual(s) assigned operational responsibility for compliance with independence requirements may communicate to the person with ultimate responsibility for the system of quality management changes in the independence requirements and how the firm's policies or procedures have been updated in response to such changes.

Two-way communication may also be among the various parties, for example, engagement teams may communicate information directly to the personnel performing activities within the firm's system of quality management.

A140. Matters communicated by the firm to engagement teams or other personnel performing activities within the firm's system of quality management may include changes to the system of quality management, to the extent that the changes are relevant to their responsibilities and enables the personnel to take prompt and appropriate action in accordance with their responsibilities.

A141. Responsibility for operating the responses designed and implemented by the firm may be assigned to:

- The engagement team, as described in paragraph A62;
- Personnel performing activities within the firm's system of quality management (e.g., assigning responsibility for the performance of an engagement quality review to an engagement quality reviewer); or
- A combination of the engagement team and personnel performing activities within the firm's system of quality management.

The firm may also use human resources external to the firm to assist in operating the responses.

*Communication with External Parties* (Ref: Para. 40(e), 41(c))

Communication Required by Law or Regulation (Ref: Para. 41(c)(i))

A142. Law, regulation or professional standards may require the firm to communicate information to external parties. For example:

- In circumstances when the firm becomes aware of non-compliance with laws and regulations by a client, relevant ethical requirements may require the firm to report the non-compliance with laws and regulations to an appropriate authority outside the client entity, or to consider whether such reporting is an appropriate action in the circumstances.
- Law, regulation or professional standards may require the firm to publish a transparency report and may specify the nature of the information that is required to be included in the transparency report.

Communication with the Network (Ref: Para. 41(c)(ii))

A143. When the firm belongs to a network, frequent communication with the network supports the network in establishing network requirements and providing network services that promote the consistent performance of quality engagements. Furthermore, the network's communication of relevant information supports the firm in the design, implementation and operation of its system of quality management. Such communication may include matters related to independence, for example, in

circumstances when relevant ethical requirements include requirements for independence that apply to network firms or employees of network firms.

Communication with Service Providers (Ref: Para. 41(c)(iii))

A144. When the firm uses a service provider, the service provider's communication of relevant information to the firm that affects the firm's system of quality management supports the firm in the design, implementation and operation of its system of quality management.

Communication to External Parties About the Firm's System of Quality Management (Ref: Para. 41(c)(iv))

A145. The firm's ability to maintain stakeholder confidence in the quality of its engagements may be enhanced through effective two-way communication between the firm and its stakeholders. For example, stakeholders' perception of the quality of engagements performed by the firm may be improved when the firm is transparent about the activities that it has undertaken to address quality, and the effectiveness of those activities.

External parties who may use information about the firm's system of quality management (Ref: Para. 41(c)(iv)(a))

A146. External parties may include management or those charged with governance of the firm's clients, the firm's network or network firms, external oversight authorities, other firms who use the work of the firm in the performance of engagements (e.g., in relation to a group audit) or service providers. External parties may also include users of the firm's engagement reports, for example, current shareholders and credit providers of the entities for whom the firm performs engagements.

A147. The firm exercises professional judgment when taking into account whether there are external parties who may use information about the firm's system of quality management. Whether there are such external parties may depend on the nature of the engagements the firm performs and the types of entities for which such engagements are performed. For example, for a firm that performs audits of financial statements of listed entities or entities that may be of significant public interest described in paragraph A23, external parties such as shareholders of such entities may use a transparency report or similar publication to inform their understanding of the quality of engagements performed by the firm. On the other hand, for a firm that only performs compilation engagements, external parties who may use information about the firm's system of quality management may be limited, and they may obtain such information through discussions and direct interaction with the firm.

Nature and circumstances of the firm (Ref: Para. 41(c)(iv)(b))

A148. Factors that may affect the firm's operating environment include the nature and circumstances of the financial markets in which the firm operates and the understanding and interest that external parties have expressed about the engagements undertaken by the firm, and the firm's processes in performing the engagements.

Nature, timing, extent and content of communications to external parties about the system of quality management (Ref: Para. 41(c)(iv))

A149. The form of communication to external parties may include a publication such as a transparency report or audit quality report, webpage, targeted communication to specific stakeholders (e.g.,



information about the results of the firm's monitoring and remediation process), or direct conversations with the external party.

A150. The information that is communicated to external parties about the firm's system of quality management may depend on a variety of factors, including the form of the communication, the nature and circumstances of the firm and the external parties with whom the communication is being undertaken. For example, the communication may contain information about:

- The nature and circumstances of the firm, such as the organizational structure and operating environment and whether it is part of a network.
- The firm's governance and leadership, such as its culture and commitment to quality and information about the individuals responsible for the leadership of the firm.
- Factors that contribute to quality engagements, for example, such information may be presented in the form of engagement quality indicators with appropriate narrative to explain the indicators.
- The results of the firm's monitoring activities and external inspections, and how the firm has remediated identified deficiencies or is otherwise responding to them.
- The evaluation undertaken in accordance with paragraph 55 of whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved, including the basis for the judgments made in undertaking the evaluation.
- How the firm has responded to emerging developments and changes in the circumstances of the firm or its engagements, including how the system of quality management has been adapted to respond to such changes.

A151. Information that is communicated to external parties about the firm's system of quality management that has the following attributes contributes to an enhanced understanding of the quality of the engagements performed by the firm:

- The information is specific to the circumstances of the firm and is prepared and presented in a timely manner. Relating the matters in the firm's communication directly to the specific circumstances of the firm may help to minimize the potential that such information becomes overly standardized and less useful over time.
- The information is presented in a clear and understandable manner that is neither misleading nor would inappropriately influence the users of the communication (e.g. the information is appropriately balanced towards positive and negative aspects of the matter being communicated).
- The information is accurate and complete in all material respects and does not contain information that is misleading.
- The information takes into consideration the information needs of the users for whom it is intended. In considering the information needs of the users, the firm may consider matters such as the level of detail that users would find meaningful and whether users have access to relevant information through other sources, for example, information located on the firm's website.

A152. In circumstances when the firm is part of a network, it may be useful to provide information about the relationship between the firm and the network in certain external communications, such as a transparency report. Such information helps facilitate an understanding of the responsibilities of the firm and the network, and clarifies how the network requirements or network services promote the consistent performance of quality engagements across the network firms. Such information may include:

- The nature of the relationship between the firm and the network and the overall structure of the network.
- Requirements established by the network for the firm or network services that are used by the firm in its system of quality management.
- Information about the overall scope and results of network monitoring activities across the network firms that the network has provided to the firm in accordance with paragraph 61, if applicable.

In some circumstances, the network may provide external communication about the above matters, for example, in the form of a network transparency report, which may support the firm in communicating the information.

A153. In some cases, law or regulation may preclude the firm from communicating information related to its system of quality management externally. For example, certain information may be subject to privacy or secrecy laws or regulations or the firm may be precluded from communicating certain information because of the duty of confidentiality under law, regulation or relevant ethical requirements.

#### **Monitoring and Remediation Process** (Ref: Para. 42–57)

A154. In addition to enabling the firm's evaluation of the system of quality management, the monitoring and remediation process facilitates the improvement of engagement quality and the system of quality management.

A155. Professional judgment is exercised in making various decisions within the monitoring and remediation process, including decisions about:

- The nature, timing and extent of the monitoring activities, including the scope of inspection of engagements.
- The evaluation of the findings from the monitoring activities, results of external inspections and other relevant information to determine whether deficiencies exist.
- How to respond to the findings from the monitoring activities, results of external inspections and other relevant information.
- The evaluation of the severity and pervasiveness of the identified deficiencies.
- Whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.

#### *Designing and Performing Monitoring Activities* (Ref: Para. 44–46)

A156. The firm's monitoring activities may comprise ongoing monitoring activities, periodic monitoring activities or a combination of both. Ongoing monitoring activities are generally routine activities, built

into the firm's processes and performed on a real-time basis, reacting to changing conditions, for example:

- An IT application that continually monitors the permissibility of financial investments recorded by personnel as part of the firm's independence responses.
- Inspection of in-process engagements that are focused on specific aspects of completed work.

Periodic monitoring activities are conducted at certain intervals by the firm, for example, inspection of training records to determine that personnel have attended training in accordance with the firm's policies or procedures or inspection of completed engagements. In most cases, ongoing monitoring activities identify deficiencies in the system of quality management in a timelier manner.

A157. The purpose of a monitoring activity is to monitor the responses in the system of quality management. The system of quality management may include responses that are similar in nature to a monitoring activity but have a different purpose (e.g., responses that are designed to detect failures or shortcomings in the system of quality management so that they can prevent an assessed quality risk from occurring). For example, in some circumstances, an in-process review of engagement documentation may be designed as a monitoring activity as part of paragraph 45, in which case the findings from that review are subject to the requirements in paragraph 47. In other circumstances, an in-process review may be designed as a response to address an assessed quality risks in the engagement performance component or other components. Determining the purpose of the response is necessary in determining its design and implementation, and where it fits within the system of quality management (i.e., whether it is a response in monitoring and remediation or a response in another component).

A158. The nature, timing and extent of the monitoring activities may be affected by factors such as:

- The size, structure and organization of the firm.
- The involvement of the network in monitoring activities.
- The resources that the firm intends to use to enable monitoring activities, for example, the use of IT applications in addition to human resources.
- The design of the response subject to monitoring. For example, the response may comprise in-process reviews of engagement documentation of selected engagements by personnel who are not members of the engagement team. The extent of the review of the engagement documentation, the nature of the matters considered in the review, and how the results of the review are collated may affect the nature, scope and frequency of the monitoring activities over the in-process review.

A159. When performing monitoring activities, the firm may determine that changes to the nature, timing and extent of the monitoring activities are needed. For example, the firm may identify findings that indicate the need for more extensive monitoring activities.

The Design of the Response and the Assessed Quality Risks (Ref: Para. 44(a))

A160. The nature, timing and extent of the firm's monitoring activities may be more robust for areas of the system of quality management where the assessed quality risks are greater and the related responses are more extensive or rigorous. For example, the firm may perform more extensive monitoring activities over compliance with independence requirements for audits of financial statements than for other types of engagements.

A161. The reasons for the assessments given to the assessed quality risks may include characteristics associated with certain engagements, for example:

- Engagements performed in respect of certain entities (e.g., a listed entity or entity that may be of significant public interest).
- Engagements where the firm or engagement partner are inexperienced, for example, a new industry, a new service offering or new engagement partner.
- Engagements that have been subject to external inspection and which had negative findings, or engagements where the findings of previous monitoring activities resulted in identified deficiencies.
- Engagements where the firm's engagement acceptance and continuance procedures indicated that matters may exist that may increase the engagement risk.

Changes in Factors That Have Affected the System of Quality Management or Changes in the System of Quality Management (Ref: Para. 44(c))

A162. Changes in factors that have affected the firm's system of quality management include changes in the nature and circumstances of the firm and its engagements (e.g., a new service offered by the firm or changes in the firm's environment). Changes in the system of quality management include:

- Changes to address an identified deficiency in the system of quality management.
- Changes to the responses, for example, because they have become obsolete over time or more effective responses are designed and implemented, such as the use of IT applications to replace manual processes.

When changes occur, previous monitoring activities undertaken by the firm may no longer provide the firm with information to support the evaluation of the system of quality management and, therefore, the firm's monitoring activities may include monitoring of those areas of change.

Previous Monitoring Activities (Ref: Para. 44(d), 50)

A163. The findings from the firm's previous monitoring activities may indicate areas of focus for the monitoring activities, for example, monitoring activities may need to continue to be undertaken in certain areas where there is a history of deficiencies. Furthermore, the monitoring activities may need to evaluate the effectiveness of the remedial actions that have been implemented to address deficiencies previously identified.

A164. Although areas of the system of quality management may not have changed, previous monitoring activities undertaken by the firm may no longer provide the firm with information to support the evaluation of areas that have not changed, for example, because of the time that has elapsed since the monitoring activities were undertaken.

Other Relevant Information (Ref: Para. 44(e), 47)

A165. Examples of sources of other relevant information may include:

- Information communicated by the network in accordance with paragraphs 60(c) and 61 about the firm's system of quality management, including the network requirements or network services that the firm has included in its system of quality management.

- Information communicated by a service provider about the resources the firm uses in its system of quality management.
- Concerns about the commitment to quality of the firm or its personnel, communicated in accordance with paragraph 24(c).
- The results of industry-wide reviews undertaken by an external oversight authority of focus areas related to systems of quality management or the performance of engagements.
- Other reviews undertaken by an external oversight authority, for example, informal reviews undertaken by an external oversight authority to assess a firm's preparation for the implementation of a new professional standard, or reviews of specific areas of focus that contribute to the improvement of engagement quality.
- Information from regulatory actions and litigation against the firm or other firms in the jurisdiction that may highlight areas for the firm to consider.
- A material restatement of financial statements, an engagement report that required reissuance or litigation against the firm.

A166. The results of external inspections or other relevant information may indicate findings or deficiencies in previous monitoring activities undertaken by the firm, which may affect the firm's consideration of whether the nature, scope and frequency of previous monitoring activities were appropriate.

A167. External inspections are not a substitute for the firm's internal monitoring activities. Nevertheless, the results of external inspections may inform the nature, timing and extent of the monitoring activities.

#### Engagement Inspections (Ref: Para. 45)

A168. The relevant factors in paragraph 44 affect the extent and frequency of selection of in-process or completed engagements or engagement partners for inspection. Other factors that may also affect the extent and frequency of selection of in-process or completed engagements or engagement partners for inspection include:

- The nature, timing and extent of other monitoring activities undertaken by the firm at the engagement level.
- The varying nature of the engagements performed by the firm.
- The size of the firm, including the number and geographic location of offices and the nature and complexity of the firm's practice and organization.

A169. The firm may establish different cyclical periods for inspecting engagement partners according to the categories of engagements they perform, for example, the firm may determine that the cyclical period for an engagement partner performing audits of financial statements is every three years, whereas a longer period may be appropriate for engagement partners performing only compilation engagements. The cycle of the inspection may be based on time (i.e., every three years as illustrated) or another factor, such as the number of engagements performed. The cyclical period may also be affected by the nature, timing and extent of inspection of in-process engagements and the results thereof.

A170. The purpose of an inspection of an in-process or completed engagement depends on how the inspection has been designed by the firm. Ordinarily, the inspection of an in-process or completed engagement includes determining that responses designed to be implemented at the engagement

level have been implemented, for example, the firm may determine whether engagement teams have applied the firm's methodology appropriately.

#### Individuals Performing the Monitoring Activities (Ref: Para. 46)

A171. As described in paragraph A65, objectivity is a fundamental principle of the IESBA Code, and the provisions of relevant ethical requirements are relevant in designing the policies or procedures addressing the objectivity of the individuals performing the monitoring activities. For example, a self-review threat may arise when an individual who performs:

- An inspection of an engagement was:
  - In the case of an audit of financial statements, an engagement team member or the engagement quality reviewer of that engagement or an engagement for a subsequent financial period; or
  - For all other engagements, an engagement team member or the engagement quality reviewer of that engagement.
- Another type of monitoring activity had participated in designing, executing or operating the response being monitored.

#### *Evaluating Findings and Identifying Deficiencies* (Ref: Para. 47)

A172. Findings represent the information accumulated from the performance of monitoring activities and may also include the results of external inspections and other relevant information about the firm's system of quality management. Findings may be positive or negative in nature.

#### Positive Findings

A173. Positive findings may be useful to the firm as they indicate practices that the firm can support or apply more extensively, for example, across all engagements. They may also highlight opportunities for the firm to enhance the system of quality management.

#### Negative Findings

A174. Negative findings are considered by the firm in accordance with paragraph 47 to determine whether there are deficiencies in the system of quality management. Not all negative findings are a deficiency in the system of quality management.

A175. Factors that a firm may consider in determining whether a finding is a deficiency include:

- The nature of the finding, for example, a finding that indicates that personnel have not adhered to the firm's policies or procedures may be indicative of a deficiency in the culture of the firm.
- The design of the monitoring activity from which the finding arose, for example, the firm may consider the tolerable error rate of the activity and whether it was designed to focus on specific areas of risk or the whole population.
- The extent of the monitoring activity from which the finding arose, including the size of sample selected relative to the size of the entire population.
- The extent of the findings in relation to the sample of the population covered by the monitoring activity.

- If the finding relates to a response:
  - The nature of the assessed quality risk to which the response relates, and the extent to which the finding indicates that the assessed quality risk has not been addressed.
  - Whether there are other responses that address the same assessed quality risk and whether there are findings for those responses.
- Whether the finding, in combination with other findings, indicate a trend or systemic issue.

A176. A finding may affect multiple responses across different components. For example, a finding that suggests that personnel assigned to an engagement were not knowledgeable about the procedures they performed in the engagement may indicate deficiencies in responses related to human resources (i.e., inappropriate competence and capabilities) as well as those related to engagement performance (i.e., inappropriate direction, supervision and review).

A177. The effectiveness of the monitoring and remediation process may be evaluated through considering the findings arising from the monitoring activities, the results of external inspections and other relevant information source (e.g., network monitoring activities or complaints and allegations). For example, external inspection findings may indicate deficiencies in the system of quality management that have not been identified by the firm's monitoring and remediation process, which highlight a deficiency in that process.

#### Root Cause of the Identified Deficiencies (Ref: Para. 48(a))

A178. This ISQM requires the firm to investigate the root cause(s) of identified deficiencies. As highlighted in paragraph A174, not all negative findings from the performance of monitoring activities, results of external inspections and other relevant information are a deficiency in the system of quality management. Although not required by this ISQM, investigating the root cause of positive findings may reveal opportunities for the firm to improve, or further enhance, the system of quality management. Identifying the root cause of positive findings on engagements where identified deficiencies did not exist may also help the firm to identify the root causes of identified deficiencies that existed in other engagements and may assist the firm in determining how to remediate identified deficiencies.

A179. The objective of investigating the root cause(s) of identified deficiencies is to understand the underlying circumstances that caused the deficiencies. An improved understanding of the underlying cause(s) of identified deficiencies may:

- Facilitate the design and implementation of more effective actions to address identified deficiencies.
- Directly contribute to the improvement of quality at the engagement level through the participation of engagement teams in the root cause analysis process.
- Enable those assigned ultimate responsibility and accountability or operational responsibility for the system of quality management to proactively monitor actions taken to address identified deficiencies.
- Facilitate more effective communication to personnel by explaining the actual root cause(s) of identified deficiencies, rather than the deficiencies themselves.

A180. Performing a root cause analysis generally involves those performing the assessment exercising professional judgment based on the evidence available. The firm's policies or procedures for the nature, timing and extent of the procedures to investigate the root cause(s) of identified deficiencies are required to take into account the nature of the deficiencies and their possible severity which may include:

- The nature and extent of the deficiency, for example, a deficiency that results in an engagement report being inappropriate has greater severity than a deficiency that resulted in the firm's policies or procedures not being followed but the engagement report was still appropriate.
- Whether the deficiency, in combination with all other identified deficiencies, indicates a trend or systemic issue, for example, there are multiple engagement reports affected by the same deficiency or certain policies or procedures appear to have high rates of non-compliance.

The procedures undertaken to understand the root cause(s) of an identified deficiency may be simple, for example, in circumstances when the possible severity of the deficiency is not significant, the root cause is apparent or, in the case of a smaller firm, those performing the root cause analysis are familiar with a variety of information to inform their understanding.

A181. There may be multiple root cause(s) of an identified deficiency, the root cause(s) may be complex and interrelated, and the root cause(s) may exist across various components of the firm's system of quality management. Furthermore, a root cause of an identified deficiency may relate to more than one identified deficiency or affect multiple components, for example, in circumstances when the root cause relates to an aspect of the firm's risk assessment process. There may also be circumstances when a single root cause relates to multiple identified deficiencies.

A182. Identifying a root cause(s) that is appropriately specific may support the firm's process for remediating identified deficiencies. For example, it may be identified that an engagement team did not exercise sufficient professional skepticism in complex areas of management judgment. However, the underlying root cause of this issue may relate to another matter, such as a cultural environment that does not encourage engagement team members to challenge individuals with greater authority or insufficient direction, supervision and review on the engagement.

#### Evaluating the Severity and Pervasiveness of Identified Deficiencies (Ref: Para. 48(b))

A183. Factors the firm may consider in evaluating the severity and pervasiveness of an identified deficiency include:

- The nature of the identified deficiency, including whether it relates to a quality objective, quality risk or a response;
- The root cause(s) of the identified deficiency;
- The frequency with which the underlying finding occurred; and
- The magnitude of the identified deficiency, the rate at which it occurred and the duration of time that it existed.

#### *Responding to Identified Deficiencies* (Ref: Para. 49–50)

A184. The nature, timing and extent of remedial actions may depend on a variety of other factors, including:

- The root cause(s), for example, whether it relates to an individual engagement, a certain category of engagements, or is more pervasive throughout the firm.



- The severity and pervasiveness of the identified deficiency and therefore the urgency in which it needs to be addressed.
- The effectiveness of the remedial actions in addressing the root cause(s), for example, the firm may need to implement more than one remedial action in order to effectively address the root cause(s), or may need to implement remedial actions as interim measures until the firm is able to implement more effective remedial actions.

#### Findings About a Particular Engagement (Ref: Para. 51)

A185. In circumstances when procedures were omitted or the report issued is inappropriate, the action taken by the firm may include:

- Consulting with appropriate individuals within the firm regarding the appropriate action.
- Discussing the matter with management of the entity or those charged with governance.
- Performing the omitted procedures.

The actions taken to correct the work performed for a specific engagement does not relieve the firm of the responsibility to investigate the root cause(s) of the identified deficiency related to the engagement.

#### *Ongoing Communication Related to the Monitoring and Remediation (Ref: Para. 52–54)*

A186. The information communicated about the monitoring and remediation to the individual(s) assigned ultimate responsibility and accountability for the system of quality management and the individual(s) assigned operational responsibility for the system of quality management provides the basis for the evaluation of the system of quality management, as required by paragraph 55.

A187. In determining the information to be communicated to personnel, including the nature and extent of such communication, the firm may consider the type of information that is relevant to the particular recipients, including the information needs of the recipients, as a result of their defined roles and responsibilities. For example:

- Information communicated to engagement teams may be focused on deficiencies that have been identified at an engagement level and therefore are likely to be relevant. It may also include positive findings that indicate practices that engagement teams could apply more extensively. In considering the information needs of the engagement team, the firm may take into account the responsibilities of the engagement team regarding such information. For example, proposed ISA 220 (Revised)<sup>33</sup> requires the engagement team to determine the relevance and effect on the audit of the results of the monitoring and remediation process, and to take appropriate action.
- Information communicated to all personnel may relate to matters relevant to compliance with the firm's independence policies or procedures as such policies or procedures may apply to all personnel.

Communicating the root cause(s) of identified deficiencies may increase awareness and understanding of why deficiencies occurred, which may influence the behavior of engagement teams

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<sup>33</sup> Proposed ISA 220 (Revised), paragraph 36(b)

and personnel. Communicating remedial actions may enable the implementation of such actions in a more proactive manner.

*Evaluating the System of Quality Management (Ref: Para. 55–57)*

A188. An effective system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.

A189. The individual(s) assigned ultimate responsibility and accountability for the system of quality management uses the information obtained in accordance with paragraph 52 in evaluating the effectiveness of the system of quality management. The nature and extent of the information, including how the information is communicated, will vary based on the nature and circumstances of the firm. For example, in a smaller firm, the individual(s) assigned ultimate responsibility and accountability for the system of quality management may be directly involved in the monitoring and remediation and will therefore be aware of the information that supports the evaluation of the system of quality management. However, in a larger firm, the individual(s) assigned ultimate responsibility and accountability for the system of quality management may not have direct involvement in the monitoring and remediation process. Therefore, the individuals assigned operational responsibility for various aspects of the system of quality management may need to collate, summarize and present the information that supports the evaluation of the system of quality management in a manner that enables the individual(s) assigned ultimate responsibility and accountability for the system of quality management to form an appropriate conclusion.

A190. Prompt and appropriate action when the evaluation indicates that the system does not provide reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved may include:

- Taking steps to determine whether the reports already issued by the firm were appropriate.
- Taking measures to confirm that reports not yet issued by the firm are appropriate in the circumstances.
- Obtaining legal advice.

A191. Circumstances when it may be appropriate for the firm to communicate to external parties that the system does not provide reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved include:

- When the firm belongs to a network and the information is relevant to the network or other firms within the network who use the work performed by the firm, for example, in the case of a group audit.
- When a report issued by the firm is determined to be inappropriate as a result of the failure of the system of quality management, and management or those charged with governance of the entity need to be informed.

In some circumstances, the firm may be required by law or regulation to communicate to an oversight authority or a regulatory body that the system does not provide reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.

**Network Requirements or Network Services** (Ref: Para. 58–63)

A192. Network requirements may include, for example:

- Requirements for the firm to include quality objectives or identified quality risks in the firm's system of quality management that are common across the network firms.
- Requirements for the firm to include responses, including resources, in the firm's system of quality management that are common across the network firms. Such responses designed by the network may include network policies or procedures that specify the leadership roles and responsibilities, including how the firm is expected to assign authority and responsibility within the firm, network developed methodologies for the performance of engagements or IT applications.
- Requirements that the firm be subject to the network's monitoring activities. These monitoring activities may relate to network requirements (e.g., monitoring that the firm has implemented the network's methodology appropriately), or to the firm's system of quality management in general.

A193. Examples of network services include services or resources that are optional for the firm to use as a response in its system of quality management, such as voluntary training programs, or a service delivery center established at the network level, or by another firm or group of firms within the same network.

A194. The network may establish responsibilities for the firm in implementing the network requirements or network services. For example, in the case of implementing an IT application developed by the network, the firm may need to have the appropriate IT infrastructure and IT processes in place.

A195. The firm's understanding of the network requirements or network services and the firm's responsibilities relating to the implementation thereof may be obtained through inquiries of, or documentation provided by, the network about matters such as:

- The network's governance and leadership.
- The procedures undertaken by the network in designing, implementing and, if applicable, operating, the network requirements or network services.
- How the network identifies and responds to changes that affect the network requirements or network services or other information, for example, changes in the professional standards or information that indicates a deficiency in the network requirements or network services.
- How the network monitors the appropriateness of the network requirements or network services, which may include through the network firms' monitoring activities, and the network's processes for remediating identified deficiencies.

A196. Paragraph 41(c) requires the firm to establish policies or procedures that address the nature, timing, extent and content of communication with the network, for example, the matters described in paragraphs 58 and A195.

*The Firm's Risk Assessment Process* (Ref: Para. 59)

A197. The network requirements or network services may affect the firm's system of quality management in the following ways:

- The firm may need to identify and assess quality risks for quality objectives provided by the network.
- The firm may need to design and implement responses to address quality risks provided by the network, or the firm may need to assess the quality risks provided by the network.
- The firm may identify additional quality risks arising from responses provided by the network, for example, quality risks may arise from the implementation of a network IT application.

A198. The network requirements or network services may need to be adapted or supplemented by the firm to appropriately address the nature and circumstances of the firm and its engagements, for example:

- The quality objectives provided by the network may not be at a sufficient level of granularity for the firm, or additional quality objectives may need to be established.
- The firm may identify additional quality risks that have not been identified by the network.
- The responses provided by the network may not be designed to address the assessed quality risks and the reasons for the assessments given to the quality risks.

*Monitoring and Remediation Process (Ref: Para. 60–63)*

A199. The monitoring activities undertaken by the network may affect the nature, timing and extent of the firm's monitoring activities. For example, the network may undertake cyclical inspections of completed engagements of the firm, which may affect the extent of inspections of in-process or completed engagements undertaken by the firm.

A200. The results of the network's monitoring activities of the firm's system of quality management may include information such as:

- A description of the monitoring activities, including their nature, timing and extent;
- Findings from the monitoring activities and deficiencies identified; and
- The network's evaluation of the root cause(s) of the identified deficiencies, the assessed effect of the deficiencies and recommended remedial actions.

A201. The information about the overall scope and results of the monitoring activities across the network firms' systems of quality management may highlight trends and common areas of identified deficiencies across the network, or examples of quality that may be replicated across the network. Such information may be used by the firm to determine the nature, timing and extent of its monitoring activities. It may also indicate deficiencies in network requirements or network services used by the firm in its system of quality management.

A202. In some circumstances, the firm may obtain information from the network about deficiencies identified in a network firm's system of quality management that affects the firm, for example, when the network firm performs work for the firm's engagements, such as in the capacity of a component auditor. The network may also gather information from the network firms regarding the results of external inspections over the network firms' systems of quality management. In some instances, law or regulation in a particular jurisdiction may prevent the network from sharing information with other firms within the network or may restrict the specificity of such information.

A203. Paragraph 42 requires the firm to evaluate the design, implementation and operation of the components of the system of quality management, which includes the network requirements or

network services used by the firm. The network requirements or network services may be monitored by the network, the firm, or a combination of both. For example, the network may undertake monitoring activities at a network level for a common methodology, however various monitoring activities at a firm level may support the evaluation of the methodology, including engagement inspections.

A204. In some cases the firm may determine that the remedial actions by the network are inadequate, or such remedial actions may take time to effectively address the identified deficiency. In such cases, the firm may need to implement its own remedial actions to address the identified deficiency until such time as the network has effectively addressed the deficiency.

#### **Service Providers** (Ref: Para. 64–65)

A205. The firm may use human resources, technological resources or intellectual resources that are obtained from a service provider. The service providers used by the firm include individuals or organizations that are external to the firm, excluding networks, network firms or other structures or organizations in the network. Examples of resources from a service provider include:

- Human resources used to perform the firm's monitoring activities or engagement quality reviews, or to provide consultation on technical matters.
- A commercial IT application used to perform audit engagements.
- Human resources used in the performance of engagements, for example, to attend a physical inventory count or inspect physical fixed assets at a remote location.
- External experts used in the performance of engagements. In such cases, there may be requirements in the other IAASB standards that address the competence, capabilities and objectivity of the external expert, understanding of the expert and agreement with the expert which apply in conjunction with the requirements of this ISQM.<sup>34</sup>
- The use of resources from a service provider does not include using the work of an entity's internal audit function in the performance of engagements, in accordance with ISA 610 (Revised 2013).<sup>35</sup>

A206. The determination of whether the matters described in paragraph 64 are relevant for a service provider depends on a variety of factors including:

- The nature of the resources provided by the service provider, including how and the extent to which it will be used within the firm.
- The reasons for the assessments given to the assessed quality risks to which the resource relates.
- Whether the resource itself gives rise to quality risks. For example, when the firm uses human resources from a service provider in the performance of engagements, there may be a quality risk that such resources do not have the competence and capabilities to perform the engagement, exercise inappropriate judgment when performing the engagement, do not implement the firm's responses at the engagement level or do not fulfill their responsibilities in accordance with relevant ethical requirements. Such quality risks may also affect the

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<sup>34</sup> See, for example, ISA 620, *Using the Work of an Auditor's Expert*.

<sup>35</sup> ISA 610 (Revised 2013), *Using the Work of Internal Auditors*

management of quality at the engagement level. For example, in circumstances when the firm uses human resources from a service provider to assist in the performance of engagement procedures, there may be a need for the engagement partner to have greater oversight on a more frequent basis and perform more in-depth reviews of work performed by the individual.

A207. The firm may establish policies or procedures that address circumstances when a service provider is used in the performance of engagements that set out the responsibility of the engagement team when engaging a service provider, which may include responsibility for certain matters in paragraph 64.

A208. Obtaining an understanding of the service provider may include understanding the conditions of the service, for example, how often updates will be provided for an IT application, limitations on the use of the IT application and how the service provider addresses confidentiality of data. Paragraph 41(c)(iii) requires the firm to establish policies or procedures that address the nature, timing, extent and content of communication with the service provider, for example, information to support the firm's understanding of the service provider and use of the resource (e.g., updates or changes to the resource or deficiencies in the resource).

A209. The firm's responsibilities in using the service provider may include matters such as the actions the firm needs to take in order to implement the resource or information the firm needs to communicate to the service provider in order that the resource can function effectively. For example, in the case of an IT application, the firm may need to have appropriate supporting IT infrastructure and IT processes in place.

A210. In determining whether the resource is appropriate, the firm may make inquiries of the service provider or request documentation from the service provider about matters such as:

- For human resources, the qualifications, experience and location of the individuals, including professional licenses or membership obligations, and how they develop and maintain the appropriate competence to perform the services.
- For technological or intellectual resources, the procedures undertaken by the service provider in designing, implementing and operating the resources.
- How the service provider identifies and responds to changes that affect the resources, for example, changes in the professional standards or information that indicates a deficiency in the resources;
- How the resource will be evaluated, monitored or remediated by the service provider.

There may be circumstances when the service provider supplies the firm with an assurance report on the description and design of their controls over the resource, and in some circumstances, it may also include assurance on the operating effectiveness of such controls.

#### **Documentation** (Ref: Para. 66–69)

A211. Documentation provides evidence that the firm complies with this ISQM, as well as law, regulation or relevant ethical requirements. It may also be useful for training personnel, ensuring the retention of organizational knowledge and providing a history of the basis for decisions made by the firm about its system of quality management. It is neither necessary nor practicable for the firm to document every matter considered, or judgment made, about its system of quality management. Furthermore, compliance with this ISQM may be evidenced by the firm through its information and communication

component, documents or other written materials, or IT applications that are integral to the components of the system of quality management.

A212. Documentation may take the form of formal written manuals, checklists and forms, may be informally documented (e.g., e-mail communication or postings on websites), or may be held in IT applications or other digital forms (e.g., in databases). Factors that may affect the firm's judgments about the form, content and extent of documentation may include:

- The size of the firm and the number of offices;
- The nature and complexity of the firm's practice and organization;
- The types of services the firm provides and the nature of the clients to whom services are provided; and
- The nature and complexity of the matter being documented, for example, whether it relates to an aspect of the system of quality management that has changed or an area of greater quality risk.

In a smaller firm, it may not be necessary to have documentation supporting matters communicated because informal communication methods may be effective. Nevertheless, the firm may determine it appropriate to document such communications in order to provide evidence that they occurred.

A213. In some instances, an external oversight authority may establish documentation requirements, either formally or informally, for example, as a result of the outcome of external inspection findings. Relevant ethical requirements may also include specific requirements addressing documentation, for example, the IESBA Code requires documentation of particular matters, including certain situations related to conflicts of interest, non-compliance with laws and regulations and independence.

A214. In some circumstances, it may be appropriate for the firm to document its process and analyses for establishing the quality objectives, identifying and assessing quality risks and designing responses to such risks, to provide a history of the basis for decisions made by the firm about its system of quality management.

## **The Components of a System of Quality Management**

1. This appendix describes the eight components of a firm's system of quality management. The components in this ISQM have similarities to the components of internal control described in the Committee of Sponsoring Organizations of the Treadway Commission *Internal Control – Integrated Framework*. For example, the governance and leadership component is similar to the entity's control environment and the firm's risk assessment process is similar to the entity's risk assessment process.

### **Governance and Leadership**

2. The governance and leadership component creates the environment in which the other components of the system of quality management operate because it addresses the firm's culture, decision-making process, actions, organizational structure and leadership. The governance and leadership component also provides the basis for the system of quality management because the firm needs to establish structures, reporting lines and appropriate authority and responsibility in order that the other components of the system of quality management can be developed. For example, in order to establish a system of quality management, the firm needs to identify the individual(s) responsible for its development. Accordingly, the governance and leadership component has a pervasive effect on the system of quality management and the other components cannot be effective if the environment in which they operate is not appropriate.

### **The Firm's Risk Assessment Process**

3. The firm's risk assessment process sets out the process the firm is required to follow in implementing the risk-based approach to quality management, which consists of establishing quality objectives, identifying and assessing quality risks to the achievement of the quality objectives and designing and implementing responses to address the assessed quality risks.
4. The firm is required to establish the quality objectives set out in this ISQM and additional quality objectives beyond those required by this ISQM, when those objectives are necessary to achieve the objective of this ISQM.
5. Quality risks arise from conditions, events, circumstances, actions or inactions that affect the achievement of the quality objectives, and which are associated with the nature and circumstances of the firm and its engagements. For example:
  - (a) *Nature and circumstances of the firm*: The firm may have a service delivery center that includes personnel who perform specific tasks for engagement teams. This may create, or increase the likelihood of, the quality risks for the appropriate direction and supervision of the engagement team and review of the work performed because the personnel may not be in the same location as the engagement partner or the engagement team.
  - (b) *Nature and circumstances of the engagements*: The firm may only perform related services engagements and because of the nature of such engagements, the firm may not identify any quality risks relating to compliance with independence requirements, because independence may not be relevant. In relation to the types of entities for which engagements are undertaken,



the firm may perform engagements for entities in a particular industry, such as banks, insurance companies and pension funds. This may create the quality risk that personnel do not have the appropriate knowledge of the industry to perform the engagement.

The nature and circumstances of the firm and its engagements also affect the assessment of the likelihood of the identified quality risks occurring and the significance of the effect of the identified quality risk on the achievement of the quality objectives.

6. The responses designed and implemented by the firm consist of:
  - (a) The responses required by this ISQM, which are organized by component; and
  - (b) Additional responses determined by the firm.The responses required by this ISQM alone will not be sufficient to address all of the firm's assessed quality risks for the quality objectives that are required to be established by this ISQM.
7. The responses designed and implemented by the firm, including the responses required by this ISQM, are affected by the nature and circumstances of the firm and its engagements. For example:
  - (a) *Nature and circumstances of the firm*: In circumstances when the firm has a service delivery center that includes personnel who perform specific tasks for engagement teams, the firm may obtain technology to facilitate interaction between the engagement partner and personnel located in the central location, to support appropriate direction and supervision.
  - (b) *Nature and circumstances of the engagements*: In circumstances when the firm performs engagements in a particular industry, the firm may provide training for personnel on matters unique to that industry, or recruit personnel with experience in the industry.
8. The firm's processes for establishing quality objectives, identifying and assessing quality risks and designing and implementing responses includes identifying changes in the nature and circumstances of the firm or its engagements and modifying the quality objectives, quality risks or responses, as appropriate, for changes in the matters described above.

### **Relevant Ethical Requirements**

9. The relevant ethical requirements component comprises the firm's processes for managing compliance with relevant ethical requirements, in order that the firm, its personnel and others subject to relevant ethical requirements, as applicable, fulfill their responsibilities in accordance with relevant ethical requirements. The processes include how threats to complying with relevant ethical requirements are identified, assessed and addressed and the firm's responses to breaches of the relevant ethical requirements. Relevant ethical requirements include those related to independence.

### **Acceptance and Continuance of Client Relationships and Specific Engagements**

10. The acceptance and continuance of client relationships and specific engagements comprises the firm's processes for consideration of matters in determining whether to accept or continue a client relationship or specific engagement. Such matters include the nature and circumstances of the engagement, the integrity and ethical values of the client, including management, and, when appropriate, those charged with governance and the firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements. This component also requires that the firm's financial and operational priorities do not lead to inappropriate judgments about whether to accept or continue a client relationship or specific engagement.

### **Engagement Performance**

11. The engagement performance component comprises the firm's actions to promote and support the consistent performance of quality engagements in accordance with professional standards and legal and regulatory requirements. This includes how the firm supports engagement teams in exercising professional judgment and, when applicable to the nature and circumstances of the engagement, exercising professional skepticism. Matters addressed in this component include the responsibilities of the engagement team, including in relation to direction, supervision and review, consultation, differences of opinion, the assembly and retention of documentation and engagement quality reviews.

### **Resources**

12. The resources component comprises the firm's processes for obtaining, developing, using, maintaining, allocating or assigning resources to enable the design, implementation and operation of the system of quality management. The resources relevant to the firm's system of quality management include human resources, technological resources and intellectual resources. Furthermore, financial resources are needed for obtaining, developing and maintaining the other types of resources. The firm may have competing priorities that affect the allocation or assignment of resources, however, the firm is required to have resource planning, and obtain, allocate or assign resources in a manner that supports the firm's commitment to quality and enables the design, implementation and operation of the firm's system of quality management.

### **Information and Communication**

13. The information and communication component comprises the firm's actions to obtain, generate or use relevant information to enable the design, implementation and operation of the system of quality management. This includes establishing an information system, whether through the use of manual or automated elements, to identify, capture, process and maintain relevant and reliable information.
14. The information and communication component also comprises two-way communication within the firm and communication with external parties, such as information about the firm's system of quality management. Such communication assists external parties in understanding the firm's activities to address quality through its system of quality management and the effectiveness of the firm's system.

### **Monitoring and Remediation Process**

15. Monitoring comprises the firm's processes for evaluating the design, implementation and operation of the system of quality management. It involves undertaking ongoing and periodic monitoring activities, and identifying and evaluating deficiencies in the system of quality management based on the findings from the monitoring activities, results of external inspections or other information sources (e.g., through the firm's complaints and allegations process). In order to understand how the deficiencies arose, this ISQM also requires the firm to understand the root cause of the identified deficiencies.
16. Remediation comprises the firm's actions for responding to identified deficiencies, which includes designing and implementing remedial actions and monitoring those actions to determine whether they appropriately address the identified deficiency. Remediation may also involve addressing the specific engagement, for example, when the identified deficiency indicates that the engagement report is inappropriate. Communication of the results of monitoring and remediation within the firm

also forms part of the firm's remedial actions, since personnel often need to be aware of the results in order to fulfill their roles and responsibilities.

17. This component also includes the responsibilities of the individual(s) assigned ultimate responsibility and accountability for the system of quality management to determine whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.

### **Interrelationship of the Components**

18. The firm's risk assessment process sets out the process the firm is required to follow in implementing the risk-based approach to quality management, and in doing so the firm is required to include the quality objectives and responses set out in each of the components of this ISQM.
19. The governance and leadership component is important to the design, implementation and operation of the other components of the system of quality management because it provides the basis for the system of quality management and also creates the environment in which the other components of the system of quality management operate.
20. Other components such as information and communication and resources have quality objectives that enable the design, implementation and operation of the system of quality management, and therefore such components may include responses that affect or relate to the other components of the system of quality management. For example, the information and communication component contains the information system that provides the information needed for the operation of the other components or the resources component addresses the establishment of human resources that are needed to operate the various aspects of the system of quality management. There may be interrelationships within the components as well, for example, human resources are needed for the development of intellectual resources.
21. There are also relationships between components because there are matters that relate to each other, for example, aspects of the relevant ethical requirements component may be relevant when accepting and continuing client relationships and specific engagements.
22. The monitoring and remediation process monitors the entire system of quality management, and therefore the monitoring activities are undertaken over all of the components of the system of quality management.

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March 2019

# **Explanatory Memorandum**

## ***ISQM 2 Engagement Quality Reviews***

Issued by the **Auditing and Assurance Standards Board**



**Australian Government**  
**Auditing and Assurance Standards Board**

## Obtaining a Copy of this Explanatory Memorandum

This Explanatory Memorandum is available on the Auditing and Assurance Standards Board (AUASB) website: [www.auasb.gov.au](http://www.auasb.gov.au)

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## **EXPLANATORY MEMORANDUM**

### ***ISQM 2 Engagement Quality Reviews***

#### **Introduction**

1. The International Auditing and Assurance Standards Board (IAASB) has issued for public comment three exposure drafts (EDs) on interrelated proposed auditing standards that address quality management at the engagement and firm level. This explanatory memorandum represents the Australian exposure of one of those standards, Proposed International Standard on Quality Management *ISQM 2 Engagement Quality Reviews* (ED-ISQM 2).
2. This Explanatory Memorandum is to be read in conjunction with the overarching Explanatory Guide *Exposure of the IAASB's Proposed Quality Management Standards in Australia*. The Explanatory Guide provides stakeholders with an overview of the approach to exposing the proposed international quality management standards in Australia.

#### **Overview**

3. This Explanatory Memorandum gives Australian stakeholders an overview of:
  - (a) Request for comments – IAASB questions and additional Australian questions;
  - (b) Background to the matters identified for further consideration by the AUASB during the review of the proposed international standard;
  - (c) How to provide comments and the Australian comment date; and
  - (d) Planned outreach in Australia to gather further feedback on the proposed standards.
4. ED-ISQM 2 includes the IAASB's Explanatory Memorandum (EM) and is provided as an attachment to this Australian Explanatory Memorandum. Importantly, the IAASB's EM presents an overview of "Significant Matters" in relation to ED-ISQM 2 which outlines to stakeholders the main changes from the extant ASQC 1 and ASA 220 and includes:
  - (a) Extending the requirement for an engagement quality review to engagements in addition to audits of a financial report;
  - (b) Enhancing the eligibility criteria for an individual to be appointed as an engagement quality reviewer;
  - (c) Enhancing the requirements and application material regarding the engagement quality reviewer's responsibilities, including nature, timing and extent of the engagement quality review procedures performed; and
  - (d) Consideration of the effect of engagement quality reviews, and other forms of engagement reviews, on the appropriate exercise of professional scepticism by engagement teams.

#### **Request for Comments**

5. The AUASB requests comments on all matters in relation to ED-ISQM 2, but specifically in relation to the questions below, which comprise both IAASB and Australian specific questions. Stakeholders' responses to IAASB and Australian specific questions will be used to inform the AUASB in their formal response to the IAASB on ED-ISQM 2. Additionally, responses will be used in future deliberations supporting the issuance of the Australian standard. Stakeholders may address only specific questions relevant to them, or raise other matters not specifically addressed by a question.

### **IAASB Questions**

*NB: There are no variations between the questions below and those in the IAASB's Explanatory Memorandum, but for completeness and ease of use by respondents they are replicated in the Australian Explanatory Memorandum for ED-ISQM 2*

1. Do you support a separate standard for engagement quality reviews? In particular, do you agree that ED-ISQM 1 should deal with the engagements for which an engagement quality review is to be performed, and ED-ISQM 2 should deal with the remaining aspects of engagement quality reviews?
2. Are the linkages between the requirements for engagement quality reviews in ED-ISQM 1 and ED-ISQM 2 clear?
3. Do you support the change from “engagement quality control review/reviewer” to “engagement quality review/reviewer?” Will there be any adverse consequences of changing the terminology in respondents' jurisdictions?
4. Do you support the requirements for eligibility to be appointed as an engagement quality reviewer or an assistant to the engagement quality reviewer as described in paragraphs 16 and 17, respectively, of ED-ISQM 2?
  - (a) What are your views on the need for the guidance in proposed ED-ISQM 2 regarding a “cooling-off” period for that individual before being able to act as the engagement quality reviewer?
  - (b) If you support such guidance, do you agree that it should be located in proposed ED-ISQM 2 as opposed to the IESBA Code?
5. Do you agree with the requirements relating to the nature, timing and extent of the engagement quality reviewer's procedures? Are the responsibilities of the engagement quality reviewer appropriate given the revised responsibilities of the engagement partner in proposed ISA 220 (Revised)?
6. Do you agree that the engagement quality reviewer's evaluation of the engagement team's significant judgments includes evaluating the engagement team's exercise of professional scepticism? Do you believe that ED-ISQM 2 should further address the exercise of professional scepticism by the engagement quality reviewer? If so, what suggestions do you have in that regard?
7. Do you agree with the enhanced documentation requirements?
8. Are the requirements for engagement quality reviews in ED-ISQM 2 scalable for firms of varying size and complexity? If not, what else can be done to improve scalability?

### **Australian Specific Questions**

*Matters for further consideration in relation to the Quality Management Standards*

Stakeholders are asked to respond to the following specific questions identified by the AUASB during its deliberations on the IAASB's development of the Quality Management Standards. Further information about the matters related to each of the questions can be found in Table 1 below.

9. Do you consider the definition of engagement teams has been consistently applied across the suite of Quality Management Standards? (Refer to **Matter 4** in table 1)
10. In relation to engagement quality reviews (Refer to **Matter 2 and 4** in table 1);
  - (a) Do you agree with the definition of Engagement Quality Reviews/Reviewer and do you consider the term to be clear and capable of application in a consistent way across engagements?

- (b) Do you agree that the engagement quality reviews should also be performed for audits of financial statements of entities that the firm determines are significant public interest entities?
- (c) Is the term “significant public interest entity” clear and capable of application in a consistent way across engagements in Australia?

*Matters for further consideration in relation to ISQM 2*

Stakeholders are asked to respond to the following specific questions identified by the AUASB during its deliberations on the IAASB’s development of ED-ISQM 2. Further information about the matters related to each of the questions can be found in Table 1 below.

- 11. Do you consider that the requirements in ED-ISQM 2 are appropriate for all engagements to which the standard will apply through ED-ISQM 1 e.g. other assurance and related services engagements and not just audits of a financial report? An example of this may be the “cooling-off periods”. (Refer to **Matter 6** in table 1)
- 12. Do you think the requirement for an engagement quality reviewers overall conclusion in paragraph 24 adds value to the performance of the engagement quality review as a whole? (Refer to **Matter 9** in table 1)
- 13. Do you consider that the responsibilities of an engagement partner in ED-220 and an engagement quality reviewer in ED-ISQM 2 are appropriate and proportionate given the objectives and nature of the two distinct roles? (Refer to **Matter 11** in table 1)
- 14. Do you think there are noted inconsistencies between EQR responsibilities to review the report/deliverable as described in paragraph 22(g) and the range of engagements to which ED-ISQM 2 applies through ED-ISQM 1 para 37(e)? (Refer to **Matter 12** in table 1)

*Considerations related to Australian Principles and Practices and Laws and Regulation*

Stakeholders are asked to respond to the following AUASB specific questions which reflect considerations for ISQM 2 related to the Australian regulatory environment and principles and practices considered appropriate in Australia.

*NB: The AUASB is yet to consider Australian modifications to this standard as part of its due process. Refer to paragraph 7 for further information*

- 15. Are there any modifications to the extant ASA 220 *Quality Control for an Audit of a Financial Report and Other Historical Financial Information*, which are still relevant to the ED-ISQM 2?
- 16. Have applicable laws and regulations been appropriately addressed in the proposed standard? Are there any references to relevant laws or regulations that have been omitted?
- 17. Whether there are any laws or regulations that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?
- 18. Whether there are any principles and practices considered appropriate in maintaining or improving audit quality in Australia that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?
- 19. What, if any, are the additional significant costs to/benefits for auditors and the business community arising from compliance with the requirements of this proposed standards? If significant costs are expected, the AUASB would like to understand:
  - (a) Where those costs are likely to occur;

- (b) The estimated extent of costs, in percentage terms (relative to audit fees); and
  - (c) Whether expected costs outweigh the benefits to the users of audit services?
20. Are there any other significant public interest matters that stakeholders wish to raise?

## Matters identified by the AUASB for further consideration

6. As part of its International Strategy, the AUASB reviews the ongoing progress of all IAASB proposed standards over the course of their development. The AUASB’s International Strategy is designed to ensure the AUASB influences international standards and guidance as early as possible, by identifying matters for consideration that achieve public interest outcomes and ensuring they serve as the most effective base for the Australian auditing and assurance standards.

Matters 1-12 in Table 1 below have been raised by the AUASB during this review process and resulted in additional questions 9-14 in the “Request for Comments” above or are the subject of an existing IAASB question as noted below.

**Table 1 – Matters Identified by the AUASB**

Matter #	Para #	Matter Raised	Brief Description
1.	ISQM 1 – para 37(e)	Linkages to proposed ISQM 1 and Scope of engagements subject to EQR	The AUASB raises for consideration that this paragraph now sets out the linkages between ISQM 1 and ISQM 2 and specifies all engagements for which an Engagement Quality Review is required to be performed in accordance with proposed ISQM 1 (revised).  IAASB have raised this at Question 1 and 2.
2.	ISQM 1 – para 19 & 37(e)	Scope of engagements subject to Engagement Quality Reviews	The AUASB raises for consideration that the scope of engagements subject to Engagement Quality Reviews now includes audits of financial statements of entities that the firm determines are significant public interest entities.  The AUASB has included a specific question in the Explanatory Memorandum, refer Question 10.
3.	11	Changes to Key Definitions	The AUASB raises for consideration the changes to the terminology from “engagement quality <b>control</b> review/reviewer” to “engagement quality review/reviewer”. This change is proposed to be consistent with the proposed ISQM 1 (revised) which now refers to quality management rather than quality control.  IAASB have raised this at Question 3.
4.	11	Definition of Engagement Team	The AUASB raises for consideration the definition of the term <b>Engagement Team</b> used across the suite of Quality Management Standards. The AUASB considers that the definitions are not used/defined consistently across the standards and are not clear and accordingly may not be capable of application in a consistent way for example Engagement Quality Reviewer, experts, specialists and group component auditors  The AUASB has included a specific question in the Explanatory Memorandum, refer Question 9.
5.	15-20	Eligibility of the engagement quality reviewer (including cooling-off period)	The AUASB raises for consideration that these amendments seek to clarify what authority the Engagement Quality Reviewer has, actions to be taken when the Engagement Quality Reviewer’s eligibility is impaired; and Engagement Quality Reviewers objectivity including, when applicable, limitations on the eligibility to be appointed an Engagement Quality Reviewer.  The AUASB also notes that further work is to be completed on the cooling-off period being coordinated with IESBA through a joint working group.

<b>Matter #</b>	<b>Para #</b>	<b>Matter Raised</b>	<b>Brief Description</b>
			IAASB have raised this at Question 4.
6.	Overall, 15-20 & A5	Application of all requirements in ED-ISQM 2 to a broad range of engagements under ISQM 1 (includes Cooling-off periods)	<p>The AUASB raises for consideration whether the requirements in ED-ISQM 2 are appropriate for all engagements to which the standard will apply through ED-ISQM 1 e.g. other assurance and related services engagements and not just audits of a financial report? An example of this may be the “cooling-off periods.”</p> <p>The AUASB has included a specific question in the Explanatory Memorandum, refer Question 11.</p>
7.	21-23	Performance of an engagement quality review	<p>The AUASB raises for consideration that these requirements seek to clarify the Engagement Quality Reviewers responsibilities in relation to evaluating the engagement team’s significant judgements. For financial statement audits this has now been linked to the requirements in ISA 220 and A80 which provides examples of significant judgements through A29-A30 of ISQM 2. ED-ISQM 2 paragraph 22(e) addresses consultation on difficult or contentious matters or matters involving differences of opinion and the conclusions arising from those consultations.</p> <p>IAASB have raised this at Question 5 and 6.</p>
8.	21(c) and A24	Consultation between the engagement team and the engagement quality reviewer	<p>The AUASB raises for considerations that this requirement deals with the risk of consultations between the engagement team and Engagement Quality Reviewer about a significant judgement, impairing the objectivity of the Engagement Quality Reviewer and the appropriate actions to take in these circumstances.</p> <p>IAASB have raised this at Question 5.</p>
9.	24	Engagement quality reviewer’s overall conclusion	<p>The AUASB raises for consideration that the requirement in ED-ISQM 2 at paragraph 24 addresses that the Engagement Quality Reviewer shall evaluate whether, the requirements of ISQM 2 have been fulfilled, and whether the Engagement Quality Review is complete. This is essentially a “stand back” provision.</p> <p>The AUASB has included a specific question in the Explanatory Memorandum, refer Question 12.</p>
10.	25 -27	Documentation	<p>The AUASB raises for consideration that ED-ISQM 2 has strengthened, clarified and been more specific in the amended documentation requirements.</p> <p>IAASB have raised this at Question 7.</p>
11.	Overall	Roles of EQR and EP	<p>The AUASB discussed whether requirements for the role of the engagement partner and the engagement quality reviewer are appropriate and proportionate given the objectives and nature of the two distinct roles in ED - ISA 220 and ED - ISQM 2.</p> <p>The AUASB has included a specific question in the Explanatory Memorandum, refer Question 13.</p>
12.	22(g)	Inconsistency between EQR responsibilities to review the report/deliverable and the range of	<p>The AUASB raises for consideration a potential inconsistency between EQR responsibilities to review the report/deliverable in paragraph 22(g) and the range of engagements to which ED-ISQM 2 applies through ED-ISQM 1 para 37(e). All engagements do not appear to be adequately addressed in ED-ISQM 2.</p>

Matter #	Para #	Matter Raised	Brief Description
		engagements to which ED-ISQM 2 applies through ED-ISQM 1 para 37(e)	

### **Consideration of Australian modifications to ASQM 2 from extant ASA 220**

7. As outlined in the Explanatory Guide *Exposure of the IAASB's Proposed Quality Management Standards in Australia*, at this stage of the exposure process the AUASB has not considered Australian modifications to the proposed standard to reflect Australian principles and practices and laws and regulations. This will be completed at a later date once the proposed international standard is finalised.
8. To guide the AUASB in the future deliberation of Australian modifications to the proposed international standard, Australian stakeholders are asked to consider whether any current Australian specific modifications contained in the extant version of ASA 220<sup>1</sup> are applicable to the proposed ASQM 2. The list of modifications in the extant ASA 220 is summarised in Appendix 1. Refer to Question 15.

### **Comment Date**

9. Comments to the AUASB will close on Wednesday 5 June 2019. This allows for the AUASB Audit Technical Group to analyse stakeholder comments and prepare a draft submission to the IAASB. The AUASB will then deliberate the content of the draft submission at a 26 June 2019 teleconference. The AUASB submission is due to the IAASB on 1 July 2019.
10. Where stakeholders for timing or other reasons cannot share a written submission with the AUASB, we request that feedback be provided in another form. Where stakeholders are intending to only share feedback directly with the IAASB, we request that:
  - (a) the AUASB is kept informed of any major concerns with the exposure drafts and if possible that the stakeholder submits or at least shares their submissions to the IAASB with the AUASB as early as possible, which may be on a confidential basis; and
  - (b) stakeholders respond directly to the AUASB on the Australian specific questions.

### **Planned Outreach in Australia**

11. The AUASB plans to hold roundtable events in Sydney, Melbourne, Brisbane and Perth. Additionally, the AUASB intends to collaborate closely with the NZAuASB and the professional bodies in their outreach plans; so that we obtain sufficient feedback from the SMP sector. The AUASB is seeking involvement from practitioners who provide services other than audit, as these revised Quality Management Standards impacts those practitioners as well. Furthermore, the AUASB expects to host webinars summarising feedback from roundtable sessions, with a view to seeking additional feedback on specific areas. The timing of outreach events will be finalised by the end of March 2019 and posted on the AUASB website.

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<sup>1</sup> Auditing Standard ASA 220 *Quality Control for an Audit of a Financial Report and Other Historical Financial Information*, last issued in May 2017

## Appendix 1:

### Extracts of Australian Amendments relating to ASQM 2 from extant ASA 220

Extant ASA 220 Para #	Australian Text
Aus 21.1	<p data-bbox="328 477 727 506"><i>Engagement Quality Control Review</i></p> <p data-bbox="328 533 1350 651">For audits of <b>financial reports</b> of listed entities, <b>and those other audit engagements, if any, for which the firm has determined that an engagement quality control review is required</b>, the engagement quality control reviewer, on performing an engagement quality control review, shall also consider the following:</p> <ul data-bbox="379 685 1366 976" style="list-style-type: none"><li data-bbox="379 685 1366 741">(a) The engagement team’s evaluation of the firm’s independence in relation to the audit engagement;</li><li data-bbox="379 775 1366 864">(b) Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations; and</li><li data-bbox="379 898 1366 976">(c) Whether audit documentation selected for review reflects the work performed in relation to the significant judgements made and supports the conclusions reached. (Ref: Para. A28-A32)</li></ul>



**ATTACHMENT 1 – PROPOSED INTERNATIONAL  
STANDARD ON QUALITY MANAGEMENT ISQM 2**

**Exposure Draft**  
**February 2019**  
*Comments due: July 1, 2019*

*International Standard on Quality Management*

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## Proposed International Standard on Quality Management 2

*Engagement Quality Reviews*

**IAASB**

International Auditing  
and Assurance  
Standards Board

## About the IAASB

This Exposure Draft was developed and approved by the International Auditing and Assurance Standards Board (IAASB).

The objective of the IAASB is to serve the public interest by setting high-quality auditing, assurance, and other related standards and by facilitating the convergence of international and national auditing and assurance standards, thereby enhancing the quality and consistency of practice throughout the world and strengthening public confidence in the global auditing and assurance profession.

The IAASB develops auditing and assurance standards and guidance for use by all professional accountants under a shared standard-setting process involving the Public Interest Oversight Board, which oversees the activities of the IAASB, and the IAASB Consultative Advisory Group, which provides public interest input into the development of the standards and guidance. The structures and processes that support the operations of the IAASB are facilitated by the International Federation of Accountants (IFAC).

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ISA.



## REQUEST FOR COMMENTS

This Exposure Draft, proposed ISQM 2, *Engagement Quality Reviews*, was developed and approved by the International Auditing and Assurance Standards Board® (IAASB®).

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by July 1, 2019.**

Respondents are asked to submit their comments electronically through the IAASB website, using the "[Submit a Comment](#)" link. Please submit comments in both a PDF and Word file. First-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website.

This publication may be downloaded from the IAASB website: [www.iaasb.org](http://www.iaasb.org). The approved text is published in the English language.

# EXPLANATORY MEMORANDUM

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## Section 1 Introduction

1. This memorandum provides background to, and an explanation of, the exposure draft of International Standard on Quality Management (ISQM) 2, *Engagement Quality Reviews* (ED-ISQM 2), which the IAASB approved for exposure in December 2018. The sections that follow describe the key issues considered by the IAASB in developing ED-ISQM 2. The proposed revisions address the most relevant public interest issues related to engagement quality reviews, including those highlighted in the Invitation to Comment (ITC) released in December 2015, [\*Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits\*](#).
2. ED-ISQM 2 is part of a package of proposed quality management standards for which the IAASB is seeking public comment. This memorandum supplements the overall explanatory memorandum, [\*The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level\*](#). The overall explanatory memorandum includes background to the IAASB's three quality management<sup>1</sup> exposure drafts, discusses the scalability of the standards and sets forth the IAASB's considerations regarding the possible effective dates of the three standards following final approval by the IAASB and approval of due process by the Public Interest Oversight Board. The overall explanatory memorandum also explains the linkages between the three quality management standards and addresses the related conforming amendments to the IAASB's International Standards on Auditing (ISAs).

## Section 2 Guide for Respondents

The IAASB welcomes comments on all matters addressed in ED-ISQM 2, but especially those identified in the Request for Comments section. Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and make specific suggestions for any proposed changes to wording. Respondents are free to address only questions relevant to them. When a respondent agrees with proposals in ED-ISQM 2, it will be helpful for the IAASB to be made aware of this view as support for the IAASB's proposals cannot always be inferred when not explicitly stated.

## Section 3 Significant Matters

### Section 3-A – Overall Matters

#### *Public Interest Matters*

3. The proposals in ED-ISQM 2 and the aspects of ED-ISQM 1<sup>2</sup> regarding engagement quality reviews are made with the public interest in the forefront. The IAASB noted in the ITC the public interest importance ascribed to engagement quality reviews by certain stakeholders, such as regulators. The overall explanatory memorandum describes the overarching public interest matters the IAASB has considered in developing the quality management exposure drafts. The IAASB also sought to explore the following possible actions identified in the ITC to address the public interest issues relevant to engagement quality reviews:

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<sup>1</sup> The IAASB has changed the terms “quality control” and “engagement quality control review” to “quality management” and “engagement quality review,” respectively. In addition, the name of the standards has been changed from “International Standard on Quality Control” to “International Standard on Quality Management”. As explained in paragraph 11 of the explanatory memorandum for ED-ISQM 1, these changes were made to reflect the new quality management approach proposed for the firm's system of quality management in ED-ISQM 1, proposed International Standard on Quality Management 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*.

<sup>2</sup> Paragraph 37(e) and related application material in proposed ISQM 1 address engagement quality reviews.

- Extending the requirement for an engagement quality review to engagements in addition to audits of financial statements.
  - Enhancing the eligibility criteria for an individual to be appointed as an engagement quality reviewer.
  - Enhancing the requirements and application material regarding the engagement quality reviewer's responsibilities, including the nature, timing and extent of the engagement quality review procedures performed.
  - Consideration of the effect of engagement quality reviews, and other forms of engagement reviews, on the appropriate exercise of professional skepticism by engagement teams.
4. The IAASB considered the importance of engagement quality reviews in the overall context of quality management and sought to address these public interest matters, as further discussed in this explanatory memorandum.

*Professional Judgment and Professional Skepticism*

5. The IAASB recognizes that engagement quality reviews support the exercise of professional skepticism at the engagement level by providing an objective evaluation of engagement teams' significant judgments made in performing an engagement. ED-ISQM 2 addresses the importance of this objective evaluation by requiring that firm policies or procedures set forth criteria for the eligibility of an individual to be appointed as an engagement quality reviewer. Such criteria include compliance with relevant ethical requirements, including that threats to objectivity of the engagement quality reviewer are eliminated or reduced to an acceptable level.
6. Further, ED-ISQM 2 requires firm policies or procedures to include limitations on the eligibility of an individual to be appointed as engagement quality reviewer for an engagement on which the individual previously served as engagement partner. This limitation is necessary to make sure that the engagement quality reviewer is in a position to objectively evaluate and, where appropriate, challenge the significant judgments made and the exercise of professional skepticism by the engagement team. The IAASB believes that this separation from the previous role as engagement partner is necessary for the engagement quality review to be an appropriate response to the assessed quality risk(s) for the engagement.
7. The IAASB also considered whether the concept of professional skepticism is relevant to professional judgments made by an engagement quality reviewer. Professional skepticism is generally described in the context of obtaining and evaluating audit evidence. ED-ISQM 2 notes that the engagement quality reviewer is not a member of the engagement team and is not required to obtain evidence to support the opinion or conclusion on the engagement. However, because the role of the engagement quality reviewer is to evaluate the significant judgments made by the engagement team, some might argue that, at least indirectly, the engagement quality reviewer also exercises professional skepticism in reviewing selected engagement documentation supporting those significant judgments and the conclusions reached thereon. Accordingly, the IAASB is seeking respondents' views on how ED-ISQM 2 addresses professional judgment and professional skepticism by the engagement quality reviewer, and whether additional guidance would be helpful in this area.
8. The IAASB also notes that the International Ethics Standards Board for Accountants' (IESBA's) project addressing the [role, mindset and behavioral characteristics expected of all professional accountants when performing their professional activities](#) may be relevant to professional judgments

made by the engagement quality reviewer. Therefore, the IAASB will continue to coordinate with IESBA in considering the effects of that project on ED-ISQM 2.

#### *Scalability for Firms of Different Sizes*

9. ED-ISQM 2 is intended to be applied by firms of all sizes based on the nature and circumstances of the engagements performed by the firm. The Appendix to this explanatory memorandum lists paragraphs that highlight how the proposed ISQM is scalable to the nature and circumstances of engagements that the firm performs.

#### **Section 3-B – The Interrelationship Between Proposed ISQM 2 and Proposed ISQM 1 and Proposed ISA 220 (Revised)<sup>3</sup>**

10. The explanatory memorandum for ED-ISQM 1 explains the firm's responsibility for establishing a system of quality management, including the new quality management approach. An engagement quality review is a response, among others, that is designed and implemented by a firm to address its assessed quality risks. Although the performance of an engagement quality review is undertaken at the engagement level, it is a response that is implemented by the engagement quality reviewer on behalf of the firm.

#### *Basis for Developing a Separate Standard for Engagement Quality Reviews*

11. The requirements for engagement quality reviews currently reside in extant ISQC 1<sup>4</sup> and ISA 220.<sup>5</sup> The IAASB concluded that having a separate standard for engagement quality reviews would provide a number of benefits, including:
  - (a) Placing emphasis on the importance of the engagement quality review.
  - (b) Facilitating the enhancement of the robustness of the requirements for the eligibility of engagement quality reviewers and the performance and documentation of the review.
  - (c) Providing a mechanism to more clearly differentiate the responsibilities of the firm and the engagement quality reviewer.
  - (d) Increasing the scalability of ED-ISQM 1 because there may be circumstances when a firm determines that there are no engagements for which an engagement quality review should be performed (e.g., a firm that performs only compilation engagements).
12. ED-ISQM 2 has been designed to operate as part of the firm's system of quality management, and therefore the IAASB observed the need for the requirements in ED-ISQM 1 and ED-ISQM 2 to be organized in a manner that provides appropriate linkages between the standards. The IAASB agreed that since the engagement quality review is a response to an assessed quality risk(s), ED-ISQM 1 should address the circumstances in which an engagement quality review should be performed. ED-ISQM 2 addresses the specific requirements for the appointment and eligibility of the engagement quality reviewer and the performance and documentation of the review. The explanatory memorandum for ED-ISQM 1 discusses the IAASB's considerations regarding the scope of

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<sup>3</sup> Proposed International Standard on Auditing (ISA) 220 (Revised), *Quality Management for an Audit of Financial Statements*

<sup>4</sup> International Standard on Quality Control 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

<sup>5</sup> ISA 220, *Quality Control for an Audit of Financial Statements*



engagements that are required to be subject to an engagement quality review in accordance with paragraph 37(e) of proposed ISQM 1.

13. Although there will no longer be requirements for the performance of engagement quality reviews in proposed ISA 220 (Revised), ED-220 contains requirements regarding the engagement partner's responsibilities relating to the engagement quality review, which largely focus on how the engagement partner and the engagement team interact with the engagement quality reviewer.

### **Section 3-C – Objective of the Standard**

14. ED-ISQM 2 is a unique standard because it addresses the responsibilities of multiple parties, i.e., the firm and the engagement quality reviewer. However, since the engagement quality reviewer is acting on behalf of the firm, the IAASB is of the view that the objective of the standard should be framed as the objective of the firm.
15. In its deliberations on the objective of ED-ISQM 2, the IAASB recognized that the objectives in the IAASB's International Standards are intended to be outcome-oriented (i.e., the desired outcome of applying the requirements in the standard, and not an "executive summary" of those requirements). Accordingly, the objective of ED-ISQM 2 reflects the intended outcome (i.e., the performance of an engagement quality review).

### **Section 3-D – Appointment and Eligibility of Engagement Quality Reviewers**

16. The IAASB recognized in the ITC concerns that had been expressed regarding the selection of the engagement quality reviewer, including the qualifications, experience and objectivity of the individual selected to perform the engagement quality review. Respondents to the ITC believed that the independence, integrity and objectivity of the engagement quality reviewer should be addressed. There was also a suggestion that the ability of the engagement quality reviewer to challenge the engagement team's judgments with confidence should be addressed, as well as the authority of the engagement quality reviewer. It was also highlighted that the engagement quality reviewer role should not be restricted to partners. Respondents also cautioned that the requirements should not be so onerous that the availability of suitable engagement quality reviewers is limited or non-existent, especially for small- and medium-sized practices (SMPs). The ITC also explored whether a cooling-off period should be required for an engagement quality reviewer who had previously been involved in the engagement.
17. In response to feedback from the ITC, the requirements in ED-ISQM 2 for the appointment and eligibility of the engagement quality reviewer (whether internal to the firm or external) are more robust than those in extant ISQC 1, as described in the subsections below. In addition, requirements and application material have been added to address:
  - The eligibility of the individual(s) within the firm responsible for the appointment of engagement quality reviewers.
  - The eligibility of individuals to assist the engagement quality reviewer in performing the engagement quality review.
  - The engagement quality reviewer taking responsibility for the performance of the engagement quality review, including that the work of individuals assisting in the review is appropriate.
  - Limitations on the eligibility of an individual to be appointed as engagement quality reviewer for an engagement for which the individual previously served as the engagement partner.

*Competence and Capabilities, Including Sufficient Time*

18. Extant ISQC 1 includes requirements regarding the criteria for eligibility of engagement quality reviewers that focus on technical qualifications, including necessary experience and authority, and maintaining the reviewer's objectivity. ED-ISQM 2 expands the eligibility requirements and describes competence and capabilities of the engagement quality reviewer in a manner similar to other roles described in ED-ISQM 1. The application material provides further explanation of considerations in determining whether an individual has the competence and capabilities needed to perform the engagement quality review for a particular engagement.
19. The IAASB highlighted in the ITC that the timing of the performance of the engagement quality review is important with respect to both when the engagement quality reviewer becomes involved in the engagement quality review and the time allocated to the engagement quality reviewer for the performance of the review. Respondents supported the importance of the reviewer being involved at the right time. The IAASB agreed and has included a new explicit requirement in paragraph 16(a) of ED-ISQM 2 that the firm's policies or procedures require that the engagement quality reviewer has sufficient time to perform the review.

*Appropriate Authority*

20. Although extant ISQC 1 refers to having the necessary authority to perform the review, it does not provide further information about how such authority is attained.
21. The IAASB is of the view that authority may be established through different means, not only through having a particular title or position within the firm. ED-ISQM 2 highlights that the firm's culture, which is addressed in ED-ISQM 1, can enhance the authority of the engagement quality reviewer by creating a culture of respect for the role of the engagement quality reviewer, which also reduces the likelihood that the engagement quality reviewer is inappropriately influenced in a way that would compromise the reviewer's evaluation of significant judgments made by the engagement team. In addition, ED-ISQM 2 notes that the firm's policies or procedures addressing differences of opinion, which are required by ED-ISQM 1, may also enhance the authority of the engagement quality reviewer by providing a mechanism for the engagement quality reviewer to resolve issues when differences of opinion arise.

*Relevant Ethical Requirements, Including Objectivity*

22. In order to improve the focus on the objectivity of the engagement quality reviewer and address the more specific threats that may arise, ED-ISQM 2 requires that the engagement quality reviewer comply with relevant ethical requirements, and specifically highlights in the application material the threats to objectivity that may arise in relation to the engagement or the engagement team.

*Appointment as the Engagement Quality Reviewer After Serving as the Engagement Partner ("Cooling-off" Period)*

23. In the ITC, the IAASB recognized concerns regarding the need to address circumstances when an individual is appointed as the engagement quality reviewer immediately after serving as the engagement partner. The IAASB noted that relevant ethical requirements, such as the IESBA *International Code of Ethics for Professional Accountants (including International Independence Standards)*, may not specifically address threats to objectivity that may arise in these circumstances. For example, a self-review or self-interest threat may arise, particularly in circumstances when judgments made by the individual in the previous engagement continue to have an effect on

subsequent periods, as is often the case in an audit of financial statements. Accordingly, the ITC suggested that this concern could be addressed through a mandatory cooling-off period.

24. Respondents to the ITC had mixed views regarding whether the IAASB should address the cooling-off period, including whether the IAASB should prescribe a cooling-off period or require firms to determine the period; whether it should be addressed by the IESBA; or whether there should be collaboration between the two Boards.
25. Given the varying views of respondents, and the need to ensure appropriate consideration of the IESBA Code, a joint working group was formed between the IAASB and IESBA to provide suggestions to the respective Boards about an appropriate way forward, recognizing each Board's mandate. Paragraphs 26-28 below further explain how the issue has been addressed in ED-ISQM 2. The IESBA is continuing to explore whether a specific provision or application material is also needed in the IESBA Code and respondents are asked to provide further input to assist the IESBA in determining its appropriate course of action.
26. The IAASB is of the view that when an individual is appointed as the engagement quality reviewer immediately after serving as the engagement partner, there are no safeguards or other actions that would eliminate the threats to the individual's objectivity or reduce them to an acceptable level. This view recognizes that the engagement quality reviewer is responsible for objectively evaluating the significant judgments made by the engagement team. In the case of an audit of financial statements, significant judgments made in prior periods often affect judgments made in subsequent periods, albeit that the facts and circumstances may change over time. The ability of the engagement quality reviewer to objectively evaluate the significant judgments is affected by previous involvement with those judgments.
27. Accordingly, ED-ISQM 2 includes a new requirement for the firm to establish policies or procedures that include limitations on the eligibility of an individual to be appointed as engagement quality reviewer for an engagement on which the individual previously served as the engagement partner. Furthermore, the application material in ED-ISQM 2 suggests such limitations may be accomplished by establishing a cooling-off period and notes that determining a suitable cooling-off period depends upon the facts and circumstances of the engagement, and applicable provisions of law or regulation and relevant ethical requirements. The application material further notes that, for an audit of a listed entity, it is unlikely that an engagement partner would be able to serve as the engagement quality reviewer until two subsequent audits have been conducted. The IAASB believes this application material recognizes that audits of listed entities generally involve more complex judgments by engagement teams and that a cooling-off period would be in the public interest. The IAASB considered, but rejected, the view that including such guidance would result in a de facto cooling-off requirement. Rather, the IAASB was of the view that including a guideline will help to support consistent application in practice.
28. The IAASB recognizes that circumstances may differ for engagements other than audits of listed entities and therefore the firm may determine that no cooling-off period is necessary for certain types of engagements, or the firm's policies or procedures may specify a different cooling-off period. The IAASB is of the view that ED-ISQM 2 provides appropriate flexibility because it places the onus on the firm to establish policies or procedures that are appropriate to address the issue.

#### Discussions with the Engagement Team

29. The IAASB recognizes the importance of encouraging discussions between the engagement partner and the engagement quality reviewer to support an effective and timely review, but also recognizes

that a potential threat to the engagement quality reviewer's objectivity could arise in some circumstances, for example, when the nature, timing or extent of the discussions create a perception that the engagement quality reviewer is making, or perceived to be making, decisions on behalf of the engagement team. Accordingly, ED-ISQM 2 requires the firm's policies or procedures to address, and sets forth appropriate actions to take in, these circumstances.

#### *Use of External Resources to Perform the Engagement Quality Review*

30. The IAASB noted in the ITC that SMPs may need to use third-party resources as engagement quality reviewers. Respondents to the ITC cautioned that the requirements should not be so onerous that the availability of suitable engagement quality reviewers is limited or non-existent, especially for SMPs. Accordingly, the application material supporting the appointment and eligibility requirements in paragraph 16 of ED-ISQM 2 clarifies that the same eligibility requirements apply to any individual to be appointed as engagement quality reviewer, whether within the firm or external (as may be the case when there is not a partner or other individual within the firm who is eligible to perform the engagement quality review).

#### **Section 3-E – Performance and Documentation of the Engagement Quality Review**

31. In the ITC, the IAASB identified issues regarding the nature, timing and extent of the procedures in performing an engagement quality review, including at what point in the engagement the engagement quality review is performed and the depth and focus of the review. Respondents to the ITC supported enhancing the requirements and application material addressing the nature, timing and extent of the procedures in performing an engagement quality review.
32. The IAASB agreed it was necessary to clarify and improve the requirements addressing the performance of the engagement quality reviews to enhance their robustness. The IAASB acknowledges the concerns raised by some respondents regarding the appropriate balance of responsibilities between the engagement quality reviewer and the engagement partner, i.e., that the responsibilities of the engagement quality reviewer should not outweigh those of the engagement partner. Recognizing the proposals in ED-220 that have enhanced the responsibilities of the engagement partner, the IAASB is seeking respondents' views on whether the requirements imposed on the engagement quality reviewer in ED-ISQM 2 are appropriate in light of the responsibilities of the engagement partner.

#### *Timing of the Engagement Quality Review*

33. The IAASB is of the view that an effective engagement quality review is achieved when the engagement quality reviewer is involved at appropriate points in the engagement, consistent with when significant judgments are being made by the engagement team, because doing so facilitates the resolution of issues in a timely manner. Accordingly, ED-ISQM 2 includes a new requirement addressing the engagement quality reviewer's responsibility to perform the procedures at appropriate points in time during the engagement.

#### *Significant Judgments and Significant Matters*

34. In the ITC, the IAASB recognized concerns regarding the extent to which the engagement quality reviewer evaluates the assessment of, and response to, areas of significant risk or significant judgment made by the engagement partner and the engagement team. The IAASB affirmed its view in extant ISQC 1 that the engagement quality review provides an objective evaluation of the significant

judgments made by the engagement team, which in the case of audits of financial statements, include significant risks.

35. The IAASB noted that extant ISQC 1 requires the engagement quality reviewer to discuss significant matters with the engagement partner, and there sometimes is confusion between the population of matters that would be considered “significant matters” versus those that are “significant judgments.” The IAASB further noted that significant judgments could include those that are not related to significant matters. The IAASB agreed that significant judgments are identified through reading and understanding the information obtained from the engagement team and the firm about the engagement, and discussing the significant matters with the engagement partner, and if applicable, other members of the engagement team.
36. The IAASB observed that the concept of “significant matters” is addressed in ISA 230.<sup>6</sup> The concept of “significant judgments,” which is integral to the definition of an engagement quality review, is addressed in proposed ISA 220 (Revised). The IAASB concluded that the engagement quality reviewer’s review of the engagement team’s significant judgments in ED-ISQM 2 needed to be consistent with the approach taken in relation to the engagement partner’s review of audit documentation in ED-220. As a result, ED-ISQM 2 includes application material to draw attention to these standards. The concepts of significant judgments and significant matters are not explicitly addressed in the standards for other types of engagements; however, the engagement quality reviewer would take into account the nature and circumstances of the engagement in identifying significant matters and significant judgments made by the engagement team. In doing so, the descriptions of those terms in ED-220 and ISA 230 may serve as useful guidance.

#### *Documentation*

37. In the ITC, the IAASB recognized concerns regarding the robustness of the documentation of the engagement quality review, including the issues raised as part of the review and the disposition of those issues.
38. ED-ISQM 2 includes a specific requirement for the engagement quality reviewer to take responsibility for documentation of the engagement quality review, and also adds a requirement that the documentation be filed with the engagement documentation. The IAASB also added an overarching requirement in ED-ISQM 2 for the documentation to be sufficient to enable an experienced practitioner, having no previous connection to the engagement, to understand the nature, timing and extent of the engagement quality review procedures performed.

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<sup>6</sup> ISA 230, *Audit Documentation*

## Section 4 Request for Comments

Respondents are asked to comment on the clarity, understandability and practicality of application of the requirements and related application material in ED-ISQM 2. Comments are most helpful if they are identified with specific aspects of ED-ISQM 2 and include the reasons for any concern about clarity, understandability and practicality of application, along with suggestions for improvement.

- 1) Do you support a separate standard for engagement quality reviews? In particular, do you agree that ED-ISQM 1 should deal with the engagements for which an engagement quality review is to be performed, and ED-ISQM 2 should deal with the remaining aspects of engagement quality reviews?
- 2) Are the linkages between the requirements for engagement quality reviews in ED-ISQM 1 and ED-ISQM 2 clear?
- 3) Do you support the change from “engagement quality control review/reviewer” to “engagement quality review/reviewer?” Will there be any adverse consequences of changing the terminology in respondents’ jurisdictions?
- 4) Do you support the requirements for eligibility to be appointed as an engagement quality reviewer or an assistant to the engagement quality reviewer as described in paragraphs 16 and 17, respectively, of ED-ISQM 2?
  - (a) What are your views on the need for the guidance in proposed ISQM 2 regarding a “cooling-off” period for that individual before being able to act as the engagement quality reviewer?
  - (b) If you support such guidance, do you agree that it should be located in proposed ISQM 2 as opposed to the IESBA Code?
- 5) Do you agree with the requirements relating to the nature, timing and extent of the engagement quality reviewer’s procedures? Are the responsibilities of the engagement quality reviewer appropriate given the revised responsibilities of the engagement partner in proposed ISA 220 (Revised)?
- 6) Do you agree that the engagement quality reviewer’s evaluation of the engagement team’s significant judgments includes evaluating the engagement team’s exercise of professional skepticism? Do you believe that ED-ISQM 2 should further address the exercise of professional skepticism by the engagement quality reviewer? If so, what suggestions do you have in that regard?
- 7) Do you agree with the enhanced documentation requirements?
- 8) Are the requirements for engagement quality reviews in ED-ISQM 2 scalable for firms of varying size and complexity? If not, what else can be done to improve scalability?

**Scalability for Firms of Different Sizes and for Engagements Where Nature and Circumstances Differ**

*Note:* This Appendix includes the relevant references to the material located within proposed ISQM 1 and ISQM 2 that incorporates scalability for firms of different sizes and for engagements where the nature and circumstances differ.

<b>How Proposed ISQM 1 and ISQM 2 Address Scalability for Engagement Quality Reviews</b>	<b>Reference</b>
<ul style="list-style-type: none"> <li>• Engagement quality reviews are not required for all of a firm’s engagements, but only for specified engagements in accordance with ED-ISQM 1.</li> <li>• ED-ISQM 1 sets forth the engagements for which engagement quality reviews are required. Those requirements apply if the firm’s portfolio includes audits of financial statements of listed entities or audits or other engagements for which an engagement quality review is required by law or regulation. In addition, engagement quality reviews are required for engagements for entities the firm determines are of significant public interest, and engagements for which an engagement quality review is an appropriate response to assessed quality risks, based on the reasons for the assessments given to those risks.</li> </ul>	<ul style="list-style-type: none"> <li>• Proposed ISQM 1 Engagement Performance – Paragraph 37(e).</li> <li>• Proposed ISQM 2 Scope of this ISQM – Paragraph 2.</li> </ul>
<ul style="list-style-type: none"> <li>• Engagement quality reviews are not an evaluation of whether the entire engagement complies with professional standards and applicable legal and regulatory requirements, or with the firm’s policies or procedures.</li> </ul>	<ul style="list-style-type: none"> <li>• The Firm’s System of Quality Management and Role of Engagement Quality Reviews – Paragraph 6.</li> </ul>
<ul style="list-style-type: none"> <li>• Certain requirements may not be relevant depending on the nature and circumstances of the engagement.</li> </ul>	<ul style="list-style-type: none"> <li>• Applying, and Complying with, Relevant Requirements – Paragraph 13.</li> <li>• Performance of the Engagement Quality Review – Paragraphs 22 and A25–A28.</li> </ul>
<ul style="list-style-type: none"> <li>• Explicit acknowledgment of circumstances of smaller firms or different types of engagements, including:</li> </ul>	<p>Appointment and Eligibility of Engagement Quality Reviewers</p>

<p><b>How Proposed ISQM 1 and ISQM 2 Address Scalability for Engagement Quality Reviews</b></p>	<p><b>Reference</b></p>
<ul style="list-style-type: none"> <li>○ Obtaining the services of external individuals to perform the engagement quality review;</li> <li>○ Firm policies or procedures to determine limitations on an individual being appointed as engagement quality reviewer immediately after serving as the engagement partner, for example, specifying a suitable cooling-off period;</li> <li>○ Consideration of the reasons for the assessments given to the quality risks in determining competence and capabilities required for an engagement; and</li> <li>○ Impact of firm culture on authority of the engagement quality reviewer.</li> </ul>	<ul style="list-style-type: none"> <li>• Assignment of Responsibility for the Appointment of Engagement Quality Reviewers – Paragraphs A2–A3.</li> <li>• Eligibility of the Engagement Quality Reviewer, Including Limitations on the Eligibility to be Appointed as the Engagement Quality Reviewer – Paragraphs A4–A5.</li> <li>• Eligibility Criteria for the Engagement Quality Reviewer – Paragraphs A7–A8.</li> </ul>
<ul style="list-style-type: none"> <li>• Relevant ethical requirements depend on the nature and circumstances of engagements subject to an engagement quality review.</li> </ul>	<ul style="list-style-type: none"> <li>• Relevant Ethical Requirements – Paragraphs A13–A14.</li> </ul>
<ul style="list-style-type: none"> <li>• Recognition that it may not be practicable for an individual other than a member of the engagement team to appoint the engagement quality reviewer in certain circumstances.</li> </ul>	<ul style="list-style-type: none"> <li>• Assignment of Responsibility for the Appointment of Engagement Quality Reviewers – Paragraph A3.</li> </ul>
<ul style="list-style-type: none"> <li>• Use of assistants in performing the engagement quality review is permitted.</li> </ul>	<ul style="list-style-type: none"> <li>• Circumstances when the Engagement Quality Reviewer is Assisted by Other Individuals – Paragraphs 17 and A18.</li> </ul>
<ul style="list-style-type: none"> <li>• The nature, timing and extent of engagement quality review procedures may vary depending on the firm’s policies or procedures or the nature and circumstances of the engagement.</li> </ul>	<ul style="list-style-type: none"> <li>• Performance of the Engagement Quality Review – Paragraph 21.</li> <li>• Procedures Performed by the Engagement Quality Reviewer – Paragraphs A25–A27.</li> <li>• Significant Matters and Significant Judgments – Paragraphs A29–A31.</li> </ul>
<ul style="list-style-type: none"> <li>• The form, content and extent of the documentation of the engagement quality review may vary.</li> <li>• The engagement quality review may be documented in a number of ways.</li> </ul>	<ul style="list-style-type: none"> <li>• Documentation – Paragraphs A37 and A38.</li> </ul>



**PROPOSED INTERNATIONAL STANDARD ON QUALITY  
MANAGEMENT 2 –  
ENGAGEMENT QUALITY REVIEWS**

(Effective as of TBD)

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Proposed International Standard on Quality Management (ISQM) 2, *Engagement Quality Reviews*, should be read in conjunction with the *Preface to the International Quality Management, Auditing, Review, Other Assurance, and Related Services Pronouncements*.

## Introduction

### Scope of this ISQM

1. This International Standard on Quality Management (ISQM) deals with:
  - The appointment and eligibility of the engagement quality reviewer; and
  - The engagement quality reviewer's responsibilities relating to performing and documenting an engagement quality review.
2. This ISQM applies to all engagements for which an engagement quality review is required to be performed in accordance with proposed ISQM 1.<sup>7</sup> This ISQM is premised on the basis that the firm is subject to proposed ISQM 1 or to national requirements that are at least as demanding.

### The Firm's System of Quality Management and Role of Engagement Quality Reviews

3. Proposed ISQM 1 establishes the firm's responsibilities for its system of quality management and requires the firm to design and implement responses to assessed quality risks related to engagement performance. Such responses include establishing policies or procedures addressing engagement quality reviews in accordance with this ISQM.
4. The objective of the firm is to design, implement and operate a system of quality management for audits or reviews of financial statements, or other assurance or related services engagements performed by the firm, that provides the firm with reasonable assurance that:
  - (a) The firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements and conduct engagements in accordance with such standards and requirements; and
  - (b) Engagement reports issued by the firm or engagement partners are appropriate in the circumstances.<sup>8</sup>
5. The public interest is served by the consistent performance of quality engagements. Quality engagements are achieved through planning and performing engagements and reporting on them in accordance with professional standards and applicable legal and regulatory requirements. Achieving the objectives of those standards and complying with the requirements of applicable law or regulation involves exercising professional judgment and, when applicable to the nature and circumstances of the engagement, exercising professional skepticism.
6. An engagement quality review is an objective evaluation of the significant judgments made by the engagement team, and the conclusions reached thereon. The engagement quality reviewer's evaluation of significant judgments is performed in the context of professional standards and applicable legal and regulatory requirements. However, an engagement quality review is not intended to be an evaluation of whether the entire engagement complies with professional standards and applicable legal and regulatory requirements, or with the firm's policies or procedures.
7. The engagement quality reviewer is not a member of the engagement team. The performance of an engagement quality review does not reduce the responsibilities of the engagement partner for

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<sup>7</sup> Proposed ISQM 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*, paragraph 37(e)

<sup>8</sup> Proposed ISQM 1, paragraph 21

managing and achieving quality on the engagement, nor does it change the nature, timing and extent of procedures that need to be performed by the engagement team. The engagement quality reviewer is not required to obtain evidence to support the opinion or conclusion on the engagement, but the engagement team may obtain further evidence through its responses to matters raised in the engagement quality review.

### **Authority of this ISQM**

8. This ISQM contains the objective for the firm in following this ISQM, and requirements designed to enable the firm and the engagement quality reviewer to meet that stated objective. In addition, it contains related guidance in the form of application and other explanatory material and introductory material that provides context relevant to a proper understanding of this ISQM, and definitions. Proposed ISQM 1 explains the terms objective, requirements, application material and other explanatory material, introductory material, and definitions.

### **Effective Date**

9. This ISQM is effective for:
  - (a) Audits and reviews of financial statements for periods beginning on or after TBD; and
  - (b) Other engagements beginning on or after TBD.

### **Objective**

10. The objective of the firm is to perform an engagement quality review for the engagement.

### **Definitions**

11. In this ISQM, the following terms have the meanings attributed below:
  - (a) Engagement quality review – An objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon, performed by the engagement quality reviewer and completed on or before the date of the engagement report.
  - (b) Engagement quality reviewer – A partner, other individual in the firm, or an external individual appointed by the firm to perform the engagement quality review.
  - (c) Relevant ethical requirements – Principles of professional ethics and ethical requirements that are applicable to a professional accountant when undertaking an engagement quality review. Relevant ethical requirements ordinarily comprise the provisions of the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA Code) related to audits or reviews of financial statements, or other assurance or related services engagements, together with national requirements that are more restrictive.

### **Requirements**

#### **Applying, and Complying with, Relevant Requirements**

12. The firm and the engagement quality reviewer shall have an understanding of this ISQM, including the application and other explanatory material, to understand the objective of this ISQM and to properly apply the requirements relevant to them.

13. The firm or the engagement quality reviewer, as applicable, shall comply with each requirement of this ISQM, unless the requirement is not relevant in the circumstances of the engagement.
14. The proper application of the requirements is expected to provide a sufficient basis for the achievement of the objective of this standard. However, if the firm or the engagement quality reviewer determines that the application of the relevant requirements does not provide a sufficient basis for the achievement of the objective of this standard, the firm or the engagement quality reviewer, as applicable, shall take further actions to achieve the objective.

### **Appointment and Eligibility of Engagement Quality Reviewers**

15. The firm shall establish policies or procedures that require the assignment of responsibility for the appointment of engagement quality reviewers to an individual(s) with the competence, capabilities and appropriate authority within the firm to fulfill the responsibility. Those policies or procedures shall require such individual(s) to appoint the engagement quality reviewer. (Ref: Para. A1–A3)
16. The firm shall establish policies or procedures that set forth the criteria for eligibility to be appointed as an engagement quality reviewer and that include limitations on the eligibility of an individual to be appointed as engagement quality reviewer for an engagement on which the individual previously served as engagement partner. Those policies or procedures shall require that the engagement quality reviewer not be a member of the engagement team, and: (Ref: Para. A4–A5)
  - (a) Have the competence and capabilities, including sufficient time, and the appropriate authority to perform the engagement quality review; (Ref: Para. A6–A12)
  - (b) Comply with relevant ethical requirements, including that threats to objectivity of the engagement quality reviewer related to the engagement or the engagement team are eliminated or reduced to an acceptable level; and (Ref: Para. A13–A16)
  - (c) Comply with requirements of law and regulation, if any, that are relevant to the eligibility of the engagement quality reviewer. (Ref: Para. A17)
17. The firm shall establish policies or procedures that set forth the criteria for eligibility of individuals who assist the engagement quality reviewer. Those policies or procedures shall require that such individuals not be members of the engagement team, and:
  - (a) Have the competence and capabilities, including sufficient time, to perform the duties assigned to them; and
  - (b) Comply with relevant ethical requirements and, if applicable, the requirements of law and regulation. (Ref: Para. A18-A19)
18. The firm shall establish policies or procedures that require the engagement quality reviewer to take responsibility for the performance of the engagement quality review, including that the work of individuals assisting in the review is appropriate.
19. The firm shall establish policies or procedures that address circumstances in which the engagement quality reviewer's eligibility to perform the engagement quality review is impaired and the appropriate actions to be taken by the firm, including the process for identifying and appointing a replacement in such circumstances. (Ref: Para. A20)
20. When the engagement quality reviewer becomes aware of circumstances that impair the engagement quality reviewer's eligibility, the engagement quality reviewer shall notify the appropriate individual(s)

in the firm, and: (Ref: Para. A21)

- (a) If the engagement quality review has not commenced, decline the appointment to perform the engagement quality review; or
- (b) If the engagement quality review has commenced, discontinue the performance of the engagement quality review.

### **Performance of the Engagement Quality Review**

21. The firm shall establish policies or procedures regarding the performance of the engagement quality review that address:

- (a) The engagement quality reviewer's responsibilities to perform procedures in accordance with paragraphs 22–23 at appropriate points in time during the engagement to provide an appropriate basis for an objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon;
- (b) The responsibilities of the engagement partner in relation to the engagement quality review, including prohibiting the engagement partner from dating the engagement report until the completion of the review; and (Ref: Para. A22–A23)
- (c) Circumstances when the nature and extent of engagement team discussions with the engagement quality reviewer about a significant judgment give rise to a threat to the objectivity of the engagement quality reviewer, and appropriate actions to take in these circumstances. (Ref: Para. A24)

22. In performing the engagement quality review, the engagement quality reviewer shall: (Ref: Para. A24–A34)

- (a) Read and understand information:
  - (i) Obtained from the engagement team about the nature and circumstances of the engagement; and
  - (ii) Provided by the firm about the results of its monitoring and remediation, in particular about identified deficiencies that may relate to, or affect, the areas involving significant judgments by the engagement team.
- (b) Discuss significant matters with the engagement partner and, if applicable, other members of the engagement team. (Ref: Para. A29)
- (c) Based on the information obtained in (a) and (b), identify the areas involving significant judgments made by the engagement team, including those related to: (Ref: Para. A30–A31)
  - (i) The overall strategy and plan for performing the engagement;
  - (ii) The performance of the engagement; and
  - (iii) Forming an opinion or conclusion, when applicable, and reporting on the engagement.
- (d) Review selected engagement documentation that supports the significant judgments made by the engagement team and the conclusions reached thereon and evaluate:
  - (i) The engagement team's basis for making the significant judgments, including when applicable, the appropriate exercise of professional skepticism;
  - (ii) Whether the engagement documentation supports the conclusions reached; and

- (iii) Whether the conclusions reached are appropriate.
  - (e) Evaluate whether appropriate consultation has taken place on difficult or contentious matters or matters involving differences of opinion and the conclusions arising from those consultations. (Ref: Para. A32)
  - (f) For audits of financial statements, evaluate the basis for the engagement partner's conclusion that the engagement partner has taken overall responsibility for managing and achieving quality on the audit engagement. (Ref: Para. A33–A34)
  - (g) Review:
    - (i) For an audit of financial statements, the financial statements and the auditor's report thereon, including, if applicable, the description of the key audit matters; or
    - (ii) For an assurance or related services engagement, the engagement report, and when applicable, the subject matter information.
23. If the engagement quality reviewer has concerns that the significant judgments made by the engagement team, or the conclusions reached thereon, are not appropriate, the engagement quality reviewer shall notify the engagement partner. If such concerns are not resolved to the engagement quality reviewer's satisfaction, the engagement quality reviewer shall notify an appropriate individual(s) in the firm that the engagement quality review cannot be completed. (Ref: Para. A35)

*Completion of the Engagement Quality Review*

24. The engagement quality reviewer shall determine whether the requirements in this ISQM with respect to the performance of the engagement quality review have been fulfilled, and whether the engagement quality review is complete. If so, the engagement quality reviewer shall notify the engagement partner that the engagement quality review is complete.

**Documentation**

25. The firm shall establish policies or procedures that require the engagement quality reviewer to take responsibility for documentation of the engagement quality review. (Ref: Para. A36–A39)
26. The firm shall establish policies or procedures that require documentation of the engagement quality review in accordance with paragraph 27, and that such documentation be included with the engagement documentation.
27. The engagement quality reviewer shall determine that the documentation of the engagement quality review is sufficient to enable an experienced practitioner, having no previous connection with the engagement, to understand the nature, timing and extent of the procedures performed by the engagement quality reviewer and, when applicable, individuals who assisted the reviewer, and the conclusions reached in performing the review. The engagement quality reviewer also shall determine that the documentation of the engagement quality review includes:
- (a) The names of the engagement quality reviewer and individuals who assisted with the engagement quality review;
  - (b) An identification of the engagement documentation reviewed;
  - (c) The engagement quality reviewer's determination in accordance with paragraph 24;
  - (d) The notifications required in accordance with paragraphs 23 and 24; and

- (e) The date of completion of the engagement quality review.

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## **Application and Other Explanatory Material**

### **Appointment and Eligibility of Engagement Quality Reviewers**

*Assignment of Responsibility for the Appointment of Engagement Quality Reviewers* (Ref: Para. 15)

- A1. Competence and capabilities that are relevant to an individual's ability to fulfill responsibility for the appointment of the engagement quality reviewer may include appropriate knowledge about:
- The responsibilities of an engagement quality reviewer;
  - The criteria in paragraph 16 regarding the eligibility of engagement quality reviewers; and
  - The nature and circumstances of the engagement subject to an engagement quality review (e.g., the nature of the entity and the composition of the engagement team).
- A2. The firm may assign more than one individual to be responsible for appointing engagement quality reviewers. For example, the firm's policies or procedures may specify a different process for appointing engagement quality reviewers for audits of listed entities than for audits of non-listed entities or other engagements.
- A3. In certain circumstances, it may not be practicable for an individual other than a member of the engagement team to appoint the engagement quality reviewer, for example, in the case of a smaller firm or a sole practitioner.

*Eligibility of the Engagement Quality Reviewer, Including Limitations on the Eligibility to be Appointed as the Engagement Quality Reviewer* (Ref: Para. 16)

- A4. In some circumstances, there may not be a partner or other individual within the firm who is eligible to perform the engagement quality review and the firm may therefore contract with, or obtain the services of, external individuals to perform the engagement quality review. An external individual may be a partner or an employee of another firm within the firm's network or a service provider. When using such an external individual, the firm is subject to the requirements for network requirements or network services in paragraphs 59–60 of proposed ISQM 1, or the requirements for service providers in paragraph 65 of proposed ISQM 1, respectively.
- A5. An individual who has served as the engagement partner is not likely to be able to perform the role of the engagement quality reviewer immediately after ceasing to be the engagement partner because it is not likely that the threats to the individual's objectivity with regard to the engagement and the engagement team can be reduced to an acceptable level. In recurring engagements, the matters on which significant judgments are made and the facts and circumstances around those significant judgments are not likely to vary to a degree such that an objective evaluation of those judgments can be made by the individual who served as the engagement partner in the immediate previous period. Accordingly, this ISQM requires the firm to establish policies or procedures that limit the eligibility of individuals to be appointed as engagement quality reviewers who previously served as the engagement partner, for example, by establishing a specified cooling-off period during which the engagement partner is precluded from being appointed as the engagement quality reviewer. Determining a suitable cooling-off period depends upon the facts and circumstances of the

engagement, and applicable provisions of law or regulation or relevant ethical requirements. In the case of an audit of financial statements of a listed entity, it is unlikely that an engagement partner would be able to act as the engagement quality reviewer until two subsequent audits have been conducted.

*Eligibility Criteria for the Engagement Quality Reviewer*

Competence and Capabilities, Including Sufficient Time (Ref: Para. 16(a))

- A6. Competence refers to the integration and application of technical competence, professional skills, and professional ethics, values and attitudes, and the appropriate experience relevant to the nature and circumstances of the engagement, including:
- An understanding of professional standards and applicable legal and regulatory requirements and of the firm's policies or procedures relevant to the engagement;
  - Knowledge of the entity's industry;
  - An understanding of, and experience relevant to, engagements of a similar nature and complexity; and
  - An understanding of the responsibilities of the engagement quality reviewer in performing and documenting the engagement quality review, which may be attained or enhanced by receiving relevant training from the firm.
- A7. An engagement quality review is a response to assessed quality risks relating to engagement performance. Accordingly, an understanding of the reasons for the assessments given to the quality risks may be an important consideration in the firm's determination of the competence and capabilities required to perform the engagement quality review for that engagement. Other factors to consider in determining whether the engagement quality reviewer has the competence and capabilities, including sufficient time, needed to evaluate the significant judgments made by the engagement team and the conclusions reached thereon include, for example:
- The nature of the entity.
  - The specialization and complexity of the industry or regulatory environment in which the entity operates.
  - The extent to which the engagement relates to matters requiring specialized expertise (e.g., with respect to information technology or specialized areas of accounting or auditing), or scientific and engineering expertise, such as may be needed for certain assurance engagements. Also see paragraph A18.
- A8. In evaluating the competence and capabilities of an individual who may be appointed as an engagement quality reviewer, the findings arising from the firm's monitoring activities (e.g., findings from the inspection of in-process or completed engagements for which the individual was an engagement team member or engagement quality reviewer) or the results of external inspections may also be relevant considerations.
- A9. A lack of appropriate competence or capabilities may affect the ability of the engagement quality reviewer to exercise appropriate professional judgment in performing the review. For example, an engagement quality reviewer who lacks relevant industry experience may not possess the ability or confidence necessary to evaluate and, where appropriate, challenge significant judgments made, and the exercise



of professional skepticism, by the engagement team on a complex, industry-specific accounting or auditing matter.

Appropriate Authority (Ref: Para. 16(a))

A10. Actions at the firm level help to establish the authority of the engagement quality reviewer. For example, by creating a culture of respect for the role of the engagement quality reviewer, the engagement quality reviewer is less likely to experience pressure from the engagement partner or other personnel to inappropriately influence the outcome of the engagement quality review. In some cases, the engagement quality reviewer's authority may be enhanced by the firm's policies or procedures to address differences of opinion, which may include actions the engagement quality reviewer may take when a disagreement occurs between the engagement quality reviewer and the engagement team.

A11. The authority of the engagement quality reviewer may be diminished when:

- The culture within the firm promotes respect for authority only of individuals at a higher level of hierarchy within the firm.
- The engagement quality reviewer has a reporting line to the engagement partner, for example, when the engagement partner holds a leadership position in the firm or is responsible for determining the compensation of the engagement quality reviewer.

Public Sector Considerations

A12. In the public sector, an auditor (e.g., an Auditor General, or other suitably qualified individual appointed on behalf of the Auditor General) may act in a role equivalent to that of the engagement partner with overall responsibility for public sector audits. In such circumstances, when applicable, the selection of the engagement quality reviewer may include consideration of the need for independence and the ability of the engagement quality reviewer to provide an objective evaluation.

*Relevant Ethical Requirements* (Ref: Para. 16(b))

A13. The relevant ethical requirements that are applicable when undertaking an engagement quality review may vary, depending on the nature and circumstances of engagements subject to an engagement quality review. Various provisions of relevant ethical requirements may apply only to individual professional accountants, such as an engagement quality reviewer, and not the firm.

A14. Relevant ethical requirements may establish requirements addressing threats created by the long association of the engagement quality reviewer with an audit client. For example, in relation to audits of public interest entities, the IESBA Code contains requirements for an engagement quality reviewer to serve a required cooling-off period after that individual has served in that role, or any combination of engagement partner, engagement quality reviewer or any other key audit partner role, for specified periods.

Threats to the Objectivity of the Engagement Quality Reviewer

A15. Threats to the engagement quality reviewer's objectivity may be created by a broad range of facts and circumstances. For example:

- A familiarity or self-interest threat may arise when the engagement quality reviewer is a close or immediate family member of the engagement partner or another member of the engagement team, or through close personal relationships with members of the engagement team.

- An intimidation threat (either implicit or explicit) may be created when pressure is exerted on the engagement quality reviewer (e.g., when the engagement partner is an aggressive or dominant individual, or the engagement quality reviewer has a reporting line to the engagement partner).

A16. Relevant ethical requirements may include requirements and guidance to identify, evaluate and address threats to objectivity. For example, the IESBA Code specifically addresses intimidation threats in certain circumstances.

*Law or Regulation Relevant to Eligibility of the Engagement Quality Reviewer (Ref: 16(c))*

A17. Law or regulation may prescribe additional requirements regarding the eligibility of the engagement quality reviewer. For example, in some jurisdictions, the engagement quality reviewer may need to possess certain qualifications or be licensed to be able to perform the review.

*Circumstances when the Engagement Quality Reviewer is Assisted by Other Individuals (Ref: Para. 17)*

A18. In certain circumstances, it may be appropriate for the engagement quality reviewer to be assisted by an individual or team of individuals, either internal or external, with the relevant expertise. For example, highly specialized knowledge, skills or expertise may be useful for understanding certain transactions undertaken by the entity to help the engagement quality reviewer evaluate the significant judgments made by the engagement team related to those transactions.

A19. When the engagement quality reviewer is assisted by an external individual, the assistant's responsibilities, including those related to compliance with relevant ethical requirements, may be set out in the contract or other agreement between the firm and the assistant.

*Impairment of the Engagement Quality Reviewer's Eligibility to Perform the Engagement Quality Review (Ref: Para. 19–20)*

A20. Factors that may be relevant to the firm in considering whether the eligibility of the engagement quality reviewer to perform the engagement quality review is impaired include:

- Whether changes in the circumstances of the engagement result in the engagement quality reviewer no longer having the appropriate competence and capabilities to perform the review;
- Whether changes in the other responsibilities of the engagement quality reviewer indicate that the individual no longer has sufficient time to perform the review; or
- Notification from the engagement quality reviewer in accordance with paragraph 20.

A21. In circumstances in which the engagement quality reviewer's eligibility to perform the engagement quality review becomes impaired, the firm's policies or procedures may set out a process by which alternative eligible individuals are identified or may specify the period of time after notification within which the firm is required to appoint a replacement.

**Performance of the Engagement Quality Review** (Ref: Para. 21–23)

*Engagement Partner Responsibilities in Relation to the Engagement Quality Review* (Ref: Para. 21(b))

A22. Proposed ISA 220 (Revised)<sup>9</sup> establishes the requirements for the engagement partner<sup>10</sup> in audit engagements for which an engagement quality review is required, including:

- Being satisfied that an engagement quality reviewer has been appointed;
- Cooperating with the engagement quality reviewer and informing members of the engagement team of their responsibility to do so;
- Discussing significant matters arising during the audit engagement, including those identified during the engagement quality review, with the engagement quality reviewer; and
- Not dating the auditor's report until the completion of the engagement quality review.

A23. ISAE 3000 (Revised)<sup>11</sup> also establishes requirements for the engagement partner in relation to the engagement quality review.

*Discussions Between the Engagement Quality Reviewer and the Engagement Team* (Ref: Para. 21(c))

A24. Frequent communication between the engagement team and engagement quality reviewer throughout the engagement may assist in facilitating an effective and timely engagement quality review. However, a threat to the objectivity of the engagement quality reviewer may be created depending on the timing and extent of the discussions with the engagement team about a significant judgment. The firm's policies or procedures may set forth the actions to be taken by the engagement quality reviewer or the engagement team to avoid situations in which the engagement quality reviewer is, or may be perceived to be, making decisions on behalf of the engagement team. For example, in these circumstances the firm may require consultation about such significant judgments with other relevant personnel in accordance with the firm's consultation policies or procedures.

*Procedures Performed by the Engagement Quality Reviewer* (Ref: Para. 21–24)

A25. The firm's policies or procedures may specify the nature, timing and extent of the procedures performed by the engagement quality reviewer and also may emphasize the importance of the engagement quality reviewer exercising professional judgment in performing the review.

A26. The timing of the procedures performed by the engagement quality reviewer may depend on the nature and circumstances of the engagement, including the nature of the matters subject to the review. Timely review of the engagement documentation by the engagement quality reviewer at appropriate points in time throughout all stages of the engagement (e.g., planning, risk assessment, performance, completion, reporting) allows matters to be promptly resolved to the engagement quality reviewer's satisfaction, on or before the date of the engagement report. For example, the engagement quality reviewer may perform procedures in relation to the overall strategy and plan for the engagement at the completion of the planning phase. In other circumstances, it may be appropriate for the engagement quality reviewer to perform the

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<sup>9</sup> Proposed International Standard on Auditing (ISA) 220 (Revised), *Quality Management for an Audit of Financial Statements*, paragraph 33

<sup>10</sup> Similar requirements exist in paragraph 36 of International Standard on Assurance Engagements (ISAE) 3000 (Revised), *Assurance Engagements other than Audits or Reviews of Historical Financial Information*

<sup>11</sup> ISAE 3000 (Revised), paragraph 36

procedures near the end of the engagement (e.g., when the engagement is not complex and is completed within a short period of time). Timely performance of the engagement quality review also may reinforce the exercise of professional judgment and, as applicable, professional skepticism, by the engagement team in planning and performing the engagement.

A27. The nature and extent of the engagement quality reviewer's procedures for a specific engagement may depend on, among other factors:

- The reasons for the assessments given to quality risks, for example, engagements performed for entities in emerging industries or with complex transactions.
- The findings arising from the firm's monitoring activities, which may indicate areas where more extensive procedures need to be performed by the engagement quality reviewer.
- The complexity of the engagement.
- The nature and size of the entity, including whether the entity is a listed entity.
- Other information relevant to the engagement, such as the results of inspections undertaken by an external oversight authority in a prior period, or concerns raised about the commitment to quality of the firm or its personnel.
- The firm's acceptance and continuance of client relationships and specific engagements, which may indicate new risks to achieving quality for an engagement.
- Whether members of the engagement team have cooperated with the engagement quality reviewer. The firm's policies or procedures may address the actions the engagement quality reviewer takes in circumstances when the engagement team has not cooperated with the engagement quality reviewer, for example, informing an appropriate individual in the firm so appropriate action can be taken to resolve the issue.
- For assurance engagements, the engagement team's consideration of, and responses to, areas of risks of material misstatement in the engagement.

A28. The nature, timing and extent of the engagement quality reviewer's procedures may need to change based on circumstances encountered in performing the engagement quality review.

Significant Matters and Significant Judgments (Ref: Para. 22(b)–(d))

A29. For audits of financial statements, proposed ISA 220 (Revised) requires the engagement partner to review audit documentation relating to significant matters<sup>12</sup> and other areas involving significant judgments, especially those relating to difficult or contentious matters identified during the course of the engagement, and the conclusions reached.<sup>13</sup>

A30. For audits of financial statements, proposed ISA 220 (Revised) provides examples of significant judgments that may be identified by the engagement partner related to the overall audit strategy and audit plan for undertaking the engagement, the execution of the engagement and the overall conclusions reached by the engagement team.<sup>14</sup>

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<sup>12</sup> ISA 230, *Audit Documentation*, paragraph A8

<sup>13</sup> Proposed ISA 220 (Revised), paragraph 29

<sup>14</sup> Proposed ISA 220 (Revised), paragraph A80

A31. For engagements other than audits of financial statements, the engagement quality reviewer may consider the nature and circumstances of the engagement in identifying significant matters, and significant judgments made by the engagement team. For example, in an assurance engagement performed in accordance with ISAE 3000 (Revised), the engagement team's determination of whether the criteria to be applied in the preparation of the subject matter information are suitable for the engagement may involve or require significant judgment. The examples in proposed ISA 220 (Revised)<sup>15</sup> also may be useful to the engagement quality reviewer in identifying significant judgments in engagements other than audits of financial statements.

Whether Consultation Has Taken Place on Difficult or Contentious Matters or Matters Involving Differences of Opinion (Ref: Para. 22(e))

A32. Proposed ISQM 1<sup>16</sup> sets out requirements for the firm to establish policies or procedures addressing consultation on difficult or contentious matters, including the engagement team's responsibilities for consultation, the matters on which consultation is required and how the conclusions should be agreed and implemented. Proposed ISQM 1<sup>17</sup> also sets out requirements for the firm to establish policies or procedures to address differences of opinion that arise within the engagement team, or between the engagement team and the engagement quality reviewer or personnel performing duties within the firm's system of quality management, including those who provide consultation.

Overall Responsibility of the Engagement Partner for Managing and Achieving Quality on the Engagement (Ref: Para. 22(f))

A33. Proposed ISA 220 (Revised) requires the engagement partner to determine, prior to dating the auditor's report, that:

- The engagement partner's involvement has been sufficient and appropriate throughout the audit engagement such that the engagement partner has the basis for determining that the significant judgments made and the conclusions reached are appropriate given the nature and circumstances of the engagement; and
- The firm's policies or procedures, and the nature and circumstances of the audit engagement, and any changes thereto, have been taken into account in complying with the requirements of proposed ISA 220 (Revised).<sup>18</sup>

A34. Other pronouncements of the IAASB, including ISRE 2400 (Revised),<sup>19</sup> ISAE 3000 (Revised),<sup>20</sup> and ISRS 4410 (Revised)<sup>21</sup> also require the engagement partner to take responsibility for the overall quality on the engagement.

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<sup>15</sup> Proposed ISA 220 (Revised), paragraph A80

<sup>16</sup> Proposed ISQM 1, paragraph 40(c)

<sup>17</sup> Proposed ISQM 1, paragraph 40(d)

<sup>18</sup> Proposed ISA 220 (Revised), paragraph 37

<sup>19</sup> International Standard on Review Engagements (ISRE) 2400 (Revised), *Engagements to Review Historical Financial Statements*, paragraph 25

<sup>20</sup> ISAE 3000 (Revised), paragraph 33

<sup>21</sup> International Standard on Related Services (ISRS) 4410 (Revised), *Compilation Engagements*, paragraph 23

The Engagement Quality Reviewer's Evaluation (Ref: Para. 23)

A35. The firm's policies or procedures may specify the individual(s) in the firm to be notified if the engagement quality reviewer has unresolved concerns that the significant judgments made by the engagement team, or the conclusions reached thereon, are not appropriate. Such individual(s) may include the individual assigned the responsibility for the appointment of engagement quality reviewers.

**Documentation** (Ref: Para. 25–27)

A36. Paragraphs 67 and 68 of proposed ISQM 1 require the firm to prepare documentation of the firm's system of quality management. Engagement quality reviews performed in accordance with this proposed ISQM are one response, among others, to a firm's quality risks related to the performance of engagements, and are therefore subject to those documentation requirements.

A37. The form, content and extent of the documentation of the engagement quality review may depend on factors such as:

- The nature and complexity of the engagement;
- The nature of the entity;
- The nature and complexity of the matters subject to the engagement quality review; and
- The extent of the engagement documentation reviewed.

A38. The engagement quality review may be documented in a number of ways. For example, the engagement quality reviewer may document the review of engagement documentation electronically in the IT application for the performance of the engagement. Alternatively, the engagement quality reviewer may document the review through means of a memorandum. The engagement quality reviewer's procedures may also be documented as part of other engagement documentation, for example, minutes of the engagement team's discussions where the engagement quality reviewer was present.

A39. Paragraph 21(b) requires that the firm's policies or procedures preclude the engagement partner from dating the engagement report until the completion of the engagement quality review, which includes resolving matters raised by the engagement quality reviewer. The documentation of the engagement quality review may be completed after the date of the engagement report, but before the assembly of the final engagement file.

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March 2019

# **Explanatory Memorandum**

## ***ISA 220 Quality Management at the Engagement Level***

Issued by the **Auditing and Assurance Standards Board**



**Australian Government**

**Auditing and Assurance Standards Board**

## Obtaining a Copy of this Explanatory Memorandum

This Explanatory Memorandum is available on the Auditing and Assurance Standards Board (AUASB) website: [www.auasb.gov.au](http://www.auasb.gov.au)

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## EXPLANATORY MEMORANDUM

### *ISA 220 Quality Management at the Engagement Level*

#### Introduction

1. The International Auditing and Assurance Standards Board (IAASB) has issued for public comment three exposure drafts (EDs) on interrelated proposed auditing standards that address quality management at the engagement and firm level. This explanatory memorandum represents the Australian exposure of one of those standards, Proposed International Standard on Auditing 220 (Revised) *Quality Management for an Audit of Financial Statements* (ED-220).
2. This Explanatory Memorandum is to be read in conjunction with the overarching Explanatory Guide *Exposure of the IAASB's Proposed Quality Management Standards in Australia*. The Explanatory Guide provides stakeholders with an overview of the approach to exposing the proposed international quality management standards in Australia.

#### Overview

3. This Explanatory Memorandum gives Australian stakeholders an overview of:
  - (a) Request for comments – IAASB questions and additional Australian questions;
  - (b) Background to the matters identified for further consideration by the AUASB during the review of the proposed international standard;
  - (c) How to provide comments and the Australian comment date; and
  - (d) Planned outreach in Australia to gather further feedback on the proposed standards.
4. ED-220 includes the IAASB's Explanatory Memorandum (EM) and is provided as an attachment to this Australian Explanatory Memorandum. Importantly, the IAASB's EM presents an overview of "Significant Matters" in relation to ED-220 which outlines to stakeholders the main changes from the existing ISA 220 including:
  - (a) Modernising the standard to acknowledge different audit delivery models. Including material outlining that regardless of location of engagement team members, the work of any individual undertaking audit procedures needs to be appropriately directed and supervised.
  - (b) Removal of material that allowed engagement team members to rely on the firm's system of quality control, unless information from the firm or other parties suggested otherwise.
  - (c) Strong emphasis on the Engagement Partner's overall responsibility for managing and achieving audit quality. This includes wording throughout the standard that the engagement partner needs to be sufficiently and appropriately involved throughout the engagement to manage and achieve quality. A new stand-back provision has also been included.
  - (d) Material relating to relevant ethical requirements has been strengthened with more focus on the engagement partner's role in dealing with relevant ethical requirements.
  - (e) Inclusion of a new section relating to engagement resources which includes human, technological and intellectual resources, and the engagement partner's responsibility to determine whether the resources assigned are sufficient and appropriate.

## **Request for Comments**

5. The AUASB requests comments on all matters in relation to ED-220, but specifically in relation to the questions below, which comprise both IAASB and Australian specific questions. Stakeholders' responses to IAASB and Australian specific questions will be used to inform the AUASB in their formal response to the IAASB on ED-220. Additionally, responses will be used in future deliberations supporting the issuance of the Australian standard. Stakeholders may address only specific questions relevant to them or raise matters not specifically addressed by a question.

### **IAASB Questions**

*NB: There are no variations between the questions below and those in the IAASB's Explanatory Memorandum, but for completeness and ease of use by respondents they are replicated in the Australian Explanatory Memorandum for ED-220.*

1. Do you support the focus on the sufficient and appropriate involvement of the engagement partner (see particularly paragraphs 11–13 and 37 of ED-220), as part of taking overall responsibility for managing quality on the engagement? Does the proposed ISA appropriately reflect the role of other senior members of the engagement team, including other partners?
2. Does ED-220 have appropriate linkages with the ISQMs? Do you support the requirements to follow the firm's policies and procedures and the material referring to when the engagement partner may depend on the firm's policies or procedures?
3. Do you support the material on the appropriate exercise of professional scepticism in managing quality at the engagement level? (See paragraph 7 and A27–A29 of ED-220)
4. Does ED-220 deal adequately with the modern auditing environment, including the use of different audit delivery models and technology?
5. Do you support the revised requirements and guidance on direction, supervision and review? (See paragraphs 27–31 and A68–A80 of ED-220)
6. Does ED-220, together with the overarching documentation requirements in ISA 230, include sufficient requirements and guidance on documentation?
7. Is ED-220 appropriately scalable to engagements of different sizes and complexity, including through the focus on the nature and circumstances of the engagement in the requirements?

### **Australian specific questions**

*Matters for further consideration in relation to the Quality Management Standards*

Stakeholders are asked to respond to the following specific questions identified by the AUASB during its deliberations on the IAASB's development of the Quality Management Standards.

8. Do you consider the definition of engagement team has been consistently applied across the suite of Quality Management Standards?  
(Refer to **Matter 3** in Table 1)

*Matters for further consideration in relation to ISA 220 (revised)*

Stakeholders are asked to respond to the following specific questions identified by the AUASB during its deliberations on the IAASB's development of ED-220. Further information about the matters related to each of the questions can be found in Table 1 below.

9. Do you support the AUASB's view that situations where somebody other than the engagement partner signs the audit report, or there are multiple partners on an engagement, should be addressed as part of the revisions to ISA 220?  
(Refer to **Matter 4** in Table 1)
10. Do you consider that the expanded *Engagement Team* definition makes it difficult to meet the requirements of the standards, in particular when Service Delivery Centres are used?  
(Refer to **Matter 5** in Table 1)

11. Do you consider that the proposed changes to ISA 220 will result in improved audit quality in Australia? If no, please describe the provisions of the proposed standard which impede the improvement of audit quality.  
(Refer to **Matter 6** in Table 1)
12. Does the drafting of the standard to emphasise the engagement partner's responsibility for managing and achieving quality at the engagement level make it difficult to practically achieve?  
(Refer to **Matter 7** in Table 1)
13. Do you support the IAASB's decision to remove from the introduction in the extant standard the paragraph that engagement teams are entitled to rely on the firm's system of quality control?  
(Refer to **Matter 8** in Table 1)
14. Do you consider that the responsibilities of an engagement partner in ED-220 and an engagement quality reviewer in ED-ISQM 2 are appropriate and proportionate given the objectives and nature of the two distinct roles?  
(Refer to **Matter 9** in Table 1)

*Considerations related to Australian Principles and Practices and Laws and Regulation*

Stakeholders are asked to respond to the following AUASB specific questions which reflect considerations for ED-220 related to the Australian regulatory environment and principles and practices considered appropriate in Australia.

*NB: The AUASB is yet to consider Australian modifications to this standard as part of its due process. Refer to paragraph 7 for further information.*

15. Are there any modifications to the extant ASA 220 *Quality Control for an Audit of a Financial Report and Other Historical Financial Information*, which are still relevant to the ED-220?
16. Have applicable laws and regulations been appropriately addressed in the proposed standard? Are there any references to relevant laws or regulations that have been omitted?
17. Whether there are any laws or regulations that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?
18. Whether there are any principles and practices considered appropriate in maintaining or improving audit quality in Australia that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?
19. What, if any, are the additional significant costs to/benefits for auditors and the business community arising from compliance with the requirements of this proposed standard? If significant costs are expected, the AUASB would like to understand:
  - a. Where those costs are likely to occur;
  - b. The estimated extent of costs, in percentage terms (relative to audit fees); and
  - c. Whether expected costs outweigh the benefits to the users of audit services?
20. Are there any other significant public interest matters that stakeholders wish to raise?

**Matters identified for further consideration by the AUASB**

6. As part of its International Strategy, the AUASB reviews the ongoing progress of all IAASB proposed standards over the course of their development. The AUASB’s International Strategy is designed to ensure the AUASB influences international standards and guidance as early as possible, by identifying matters for consideration that achieve public interest outcomes and ensuring they serve as the most effective base for the Australian auditing and assurance standards.

Matters 1-9 in Table 1 below have been raised by the AUASB during this review process and have either resulted in additional questions 8-14 in the ‘Request for Comments’ above or are the subject of an existing IAASB question.

**Table 1 – Matters Identified by the AUASB**

<b>Matter #</b>	<b>ED Para</b>	<b>Matter Raised</b>	<b>Brief Description</b>
<b>1</b>	13(b)	Monitoring and reviewing work of assignees	The AUASB raises for consideration whether it is difficult to meet this requirement when performing a large audit engagement, especially with the expanded engagement team definition.  Refer to Question 1.
<b>2</b>	27	Guidance Direction and Supervision	The AUASB raises for consideration whether the requirements of paragraph 27 are practical when interacting with the expanded engagement team definition.  Refer to Question 5.
<b>3</b>	Overall	Ambiguity of definitions across the QM suite in relation to Engagement Team	The AUASB raises for consideration how the definition of Engagement Team has been applied across the suite of quality management standards.  Whilst the definition is consistent across each of the quality management standards, the application material which describes how to apply the definition is not.  For example the application materials to ED-220 outlines that a service delivery centre may be part of an engagement team and that an engagement quality reviewer is not. In ED-ISQM 1 this is not clear.  Refer to Question 8.
<b>4</b>	Overall	Engagement Partner	The AUASB discussed that in practice, there are multiple scenarios (including for listed entities) where engagements can have more than one partner.  This may result in a duplication of effort by the partners and a lack of clarity about how to meet the requirements of ASA 220.  The AUASB raises for consideration whether ED-220 should address this as part of the revisions.  Refer to Question 9.
<b>5</b>	10(d) & A16-A19	Definitions	The definition of engagement team in ED-220 is supported by application material which extends the definition of engagement team to service delivery centres (SDC) and individuals from networks or other firms.  The AUASB raises for consideration whether there could be further clarity in the standard when it comes to the engagement leader’s responsibility for oversight of members of the expanded engagement team.  Refer to Question 10.

<b>Matter #</b>	<b>ED Para</b>	<b>Matter Raised</b>	<b>Brief Description</b>
<b>6</b>	Overall	How do the changes improve audit quality?	<p>Considering the nature and extent of changes in ED-220 the AUASB raises for consideration whether the requirements in ED-220 will contribute to improved audit quality in Australia.</p> <p>Refer to Question 11.</p>
<b>7</b>	Overall	Requirements	<p>The AUASB notes that the language used to emphasize the engagement partner’s responsibilities has changed from “shall be satisfied” to “shall determine”.</p> <p>This change appears to result in a higher bar for an engagement partner to meet and in combination with other changes in the proposed standard such as the removal of the explicit statement that an engagement partner may rely on the firm/network’s system of quality control, may make the bar difficult to practically achieve.</p> <p>Refer to Question 12.</p>
<b>8</b>	Overall	Network reliance	<p>The AUASB raises for consideration the removal from the introductory paragraph of the extant standard the paragraph that “engagement team are entitled to rely on the firm’s system of quality control”.</p> <p>The statement was removed and a modified version was included as part of the application and explanatory material. Areas of the standard have also been modified to explicitly state that the firm’s system cannot be relied upon by the engagement partner.</p> <p>Refer to Question 13.</p>
<b>9</b>	Overall	Roles of EP and EQR	<p>The AUASB raises for consideration whether the responsibilities of an engagement partner in ISA 220 and an engagement quality reviewer in ISQM 2 are appropriate and proportionate given their respective roles.</p> <p>It appears that the expectations of an EQR has noticeably increased from the extant standard and may not reflect the nature and objectives of the role.</p> <p>Refer to Question 14.</p>

### **Consideration of Australian modifications from the extant ASA 220**

7. As outlined in the Explanatory Guide *Exposure of the IAASB’s Proposed Quality Management Standards in Australia*, at this stage of the exposure process the AUASB has not considered Australian modifications to the proposed standard to reflect Australian principles and practices and laws and regulations. This will be completed at a later date once the proposed international standard is finalised.
8. To guide the AUASB in the future deliberation of Australian modifications to the proposed international standard, Australian stakeholders are asked to consider whether any current Australian specific modifications contained in the extant version of ASA 220<sup>1</sup> are applicable to the proposed revised ISA 220. The list of modifications in the extant ASA 220 is summarised in Appendix 1. Refer to Question 15.

<sup>1</sup> Auditing Standard ASA 220 *Quality Control for an Audit of a Financial Report and Other Historical Financial Information*



## **Comment Date**

9. Comments to the AUASB will close on Wednesday 5 June 2019. This allows for the AUASB Audit Technical Group to analyse stakeholder comments and prepare a draft submission to the IAASB. The AUASB will then deliberate the content of the draft submission at a 26 June 2019 teleconference. The AUASB submission is due to the IAASB on 1 July 2019.
10. Where stakeholders for timing or other reasons cannot share a written submission with the AUASB, we request that feedback be provided in another form. Where stakeholders are intending to only share feedback directly with the IAASB, we request that:
  - (a) the AUASB is kept informed of any major concerns with the exposure drafts and if possible that the stakeholder submits or at least shares their submissions to the IAASB with the AUASB as early as possible, which may be on a confidential basis; and
  - (b) stakeholders respond directly to the AUASB on the Australian specific questions.

## **Australian Proposed Outreach**

11. The AUASB plans to hold roundtable events in Sydney, Melbourne, Brisbane and Perth. Additionally, the AUASB intends to collaborate closely with the NZAuASB and the professional bodies in their outreach plans; so that we obtain sufficient feedback from the SMP sector. The AUASB is seeking involvement from practitioners who provide services other than audit, as the revised Quality Management Standards impacts those practitioners as well. Furthermore, the AUASB expects to host webinars summarising feedback from roundtable sessions, with a view to seeking additional feedback on specific areas. The timing of outreach events will be finalised by the end of March 2019 and posted on the AUASB website.

## Appendix 1 –Australian Modifications to extant ASA 220

Extant ASA 220 para #	Australian Text in ASA 220
Aus 7.1	Assurance practitioner means a person or an organisation, whether in public practice, industry, commerce or the public sector, providing assurance services.
Aus 7.2	Engagement partner should be read as referring to a public sector equivalent where relevant.
Aus 7.3	Firm means a sole practitioner, partnership, or corporation or other entity of assurance practitioners. Firm should be read as referring to a public sector equivalent where relevant.
Aus 7.4	Partner means any individual with authority to bind the firm with respect to the performance of an audit of a financial report or historical financial information. Partner should be read as referring to a public sector equivalent where relevant.
Aus 7.5	Australian Auditing Standards means the suite of auditing standards issued by the AUASB, and includes ASA 805 <i>Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement</i> , and ASA 810 <i>Engagements to Report on Summary Financial Statements</i> .
Aus 7.6	Relevant ethical requirements means relevant ethical requirements as defined in ASA 102.*
Aus A2.1	<p><i>Reliance on the Firm’s System of Quality Control</i></p> <p>Notwithstanding reliance by the engagement team on the firm’s system of quality control, for audits undertaken in accordance with the <i>Corporations Act 2001</i> (the Act), the engagement partner is required to comply with the auditing standards under section 307A of that Act.</p>
Aus A4.1	<p><i>Compliance with Relevant Ethical Requirements</i></p> <p>The auditor is subject to relevant ethical requirements, including those pertaining to independence, relating to audit engagements as defined in ASA 102.</p>
A5	[Deleted by the AUASB. Refer ASA 102]
Aus A5.1	<p><i>Independence</i></p> <p>Examples of independence requirements that may be applicable are addressed in the <i>Corporations Act 2001</i>, Part 2M.3 Division 3, and relevant ethical requirements in ASA 102.</p>
Aus A6.1	<p><i>Threats to Independence</i></p> <p>The familiarity threat is particularly relevant in the context of financial report audits of listed entities. For these audits, relevant ethical requirements and the <i>Corporations Act 2001</i> specify the partner rotation requirements.</p>

ATTACHMENT 1 – PROPOSED INTERNATIONAL  
STANDARD ON AUDITING 220 (REVISED)

**Exposure Draft  
February 2019**

*Comments due: July 1, 2019*

*International Standard on Auditing*

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## Proposed International Standard on Auditing 220 (Revised)

### *Quality Management for an Audit of Financial Statements*

**IAASB**

International Auditing  
and Assurance  
Standards Board

## About the IAASB

This Exposure Draft was developed and approved by the International Auditing and Assurance Standards Board (IAASB).

The objective of the IAASB is to serve the public interest by setting high-quality auditing, assurance, and other related standards and by facilitating the convergence of international and national auditing and assurance standards, thereby enhancing the quality and consistency of practice throughout the world and strengthening public confidence in the global auditing and assurance profession.

The IAASB develops auditing and assurance standards and guidance for use by all professional accountants under a shared standard-setting process involving the Public Interest Oversight Board, which oversees the activities of the IAASB, and the IAASB Consultative Advisory Group, which provides public interest input into the development of the standards and guidance. The structures and processes that support the operations of the IAASB are facilitated by the International Federation of Accountants (IFAC).

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ISA.

IAASB

International Auditing  
and Assurance  
Standards Board®

## REQUEST FOR COMMENTS

This Exposure Draft, proposed ISA 220 (Revised), *Quality Management for an Audit of Financial Statements* was developed and approved by the International Auditing and Assurance Standards Board® (IAASB®).

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by July 1, 2019.**

Respondents are asked to submit their comments electronically through the IAASB website, using the "[Submit a Comment](#)" link. Please submit comments in both a PDF and Word file. First-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website.

This publication may be downloaded from the IAASB website: [www.iaasb.org](http://www.iaasb.org). The approved text is published in the English language.

# EXPLANATORY MEMORANDUM

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## Introduction

1. This memorandum provides background to, and an explanation of, the Exposure Draft of proposed ISA 220 (Revised), *Quality Management for an Audit of Financial Statements* (ED-220), which was approved for exposure by the IAASB in December 2018.
2. ED-220 is part of a package of proposed quality management standards in respect of which the IAASB is seeking public comment. This memorandum supplements the overall explanatory memorandum, [The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level](#). The overall explanatory memorandum includes background to the IAASB's three quality management Exposure Drafts, discusses the scalability of the standards and sets forth the IAASB's considerations regarding the possible effective dates of the three standards following final approval by the IAASB and approval of due process by the Public Interest Oversight Board. The overall explanatory memorandum also explains the linkages between the three quality management standards and addresses the related conforming amendments to the IAASB's International Standards on Auditing (ISAs).

## Section 1 Guide for Respondents

The IAASB welcomes comments on all matters addressed in ED-220, but especially those identified in the Request for Comments section. Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and make specific suggestions for any proposed changes to wording. Respondents are also free to address only questions relevant to them. When a respondent agrees with proposals in ED-220, it will be helpful for the IAASB to be made aware of this view as support for the IAASB's proposals cannot always be inferred when not stated.

## Section 2 Significant Matters

### Section 2-A – Overall Matters

#### *Public Interest Matters*

3. In revising ISA 220, the IAASB sought to address public interest considerations by encouraging proactive management of quality at the engagement level, emphasizing the importance of the exercise of professional skepticism, enhancing the documentation of the auditor's judgments, keeping ISA 220 fit for purpose in a wide range of circumstances and in a complex environment, and reinforcing the need for robust communications during the audit.<sup>1</sup>
4. In support of these goals, the IAASB agreed to:
  - Highlight the importance of the public interest role of audits, and improve the emphasis on the importance of the appropriate application of professional judgment and exercise of professional skepticism (see paragraphs 5–6 below);
  - Clarify the role and responsibilities of the engagement partner, particularly the required involvement of the engagement partner throughout the audit, and retain the emphasis on the engagement partner's responsibility for managing and achieving quality at the engagement level (see Section 2-B below);

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<sup>1</sup> The public interest issues that the IAASB was seeking to address are explained further in the [Project Proposal](#), paragraph 21.



- Modernize ISA 220 for an evolving environment, including changes in audit delivery models and the use of technology (see paragraphs 7–9 below); and
- Clarify the relationship between ED-220 and the ISQMs, including additional clarification of the engagement partner’s and engagement team’s interaction with the firm, and the engagement team’s, ability to depend on the firm’s quality management policies or procedures (see paragraphs 10–11 below).

#### The Public Interest Role of Audits and the Exercise of Professional Skepticism

5. The IAASB believes that it is important to emphasize that the public interest is served by the consistent performance of quality engagements. Accordingly, ED-220 highlights that the public interest is served by the consistent performance of quality audit engagements (see paragraph 6 of ED-220 and paragraphs 19–21 of the explanatory memorandum in ED-ISQM 1).
6. In addition, the IAASB has included new introductory material on the importance of the use of professional skepticism and professional judgment in performing audit engagements (see paragraph 7 of ED-220). This introductory material is further supported by application material that describes impediments to professional skepticism, auditor biases, and actions the engagement partner can take to deal with impediments to the exercise of professional skepticism.

#### Modernizing ISA 220 for an Evolving Environment

7. The [Invitation to Comment \(ITC\), \*Enhancing Audit Quality in the Public Interest\*](#), noted that the project to revise ISA 220 could acknowledge the evolving use of audit delivery models<sup>2</sup> and emphasize the need for appropriate policies and procedures for these structures as part of the firm’s system of quality control and at the engagement level. Respondents to the ITC were supportive of this suggestion.
8. ED-220 now recognizes that engagement teams may be organized in a variety of ways including being located together or across different geographic locations, or organized by the activity they are performing. ED-220 also recognizes that individuals who are involved in the audit engagement may not necessarily be engaged or employed directly by the firm. Importantly, the change recognizes that, regardless of the location or employment status of such individuals, if they are performing audit procedures, then their work needs to be appropriately directed, supervised and reviewed. As a consequence, changes have been made to the definition of the engagement team to recognize different and evolving engagement team structures (see Section 2-E below).
9. ED-220 also highlights the growing role of technology in audits of financial statements. The requirements in the Resources section have been enhanced and cover not only the human resources involved in an audit engagement, but also the technology and intellectual resources. Paragraphs A56–A58 explain how technological resources may be used in the audit (see also Section 2-D below). The ED also notes the role of specialized skills or knowledge in the use of automated tools. In proposing amendments to the ISA, the IAASB took into account the learnings of the IAASB’s Data Analytics Working Group, which is exploring the use of technology on audits.

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<sup>2</sup> See paragraph 117 of the ITC for an explanation of audit delivery models.

## The Interaction Between ED-220 and Proposed ISQM 1 and Proposed ISQM 2

10. ED-220 is designed to operate as part of the broader system of quality management established by ISQM 1.<sup>3</sup> Under ED-ISQM 1, the firm establishes quality objectives, identifies and assesses quality risks, and designs responses to address the quality risks in relation to the components of the firm's system of quality management. The responses may be implemented at the firm level or at the engagement level, depending on the nature and circumstances of the firm and the engagement.<sup>4</sup> Accordingly, ED-ISQM 1 requires the firm to communicate information to the engagement team about their responsibilities regarding the firm's responses that are required to be implemented at the engagement level.
11. Extant ISA 220 includes requirements and guidance on the performance of an engagement quality review (formerly known as an engagement quality control review) of the audit, including requirements directed at the engagement quality reviewer. These requirements and guidance are now proposed to be moved to proposed ISQM 2<sup>5</sup> and, therefore, ED-220 is focused only on the responsibilities of the engagement partner in this regard, including how the engagement partner and engagement team interact with the engagement quality reviewer.

## The role of the firm's policies or procedures at the engagement level

12. Extant ISA 220 notes that engagement teams are entitled to rely on the firm's system of quality control, unless information provided by the firm or other parties suggests otherwise. The IAASB has proposed removing this material, and replacing it with application material that explains that in certain circumstances, the engagement partner may "depend on the firm's policies or procedures" in complying with the requirements of ED-220. This approach is intended to avoid the risk that the engagement team blindly relies on the firm's system of quality management without taking into account whether the firm's quality management policies or procedures are "fit-for-purpose" in the specific circumstances of the engagement. To assist the engagement partner in making the determination as to whether, and the degree to which, the engagement partner may depend on the firm's policies or procedures, the IAASB has also proposed application material that provides examples of 'matters' that the engagement partner may take into account when determining whether it is appropriate to depend on the firm's policies or procedures (see paragraphs A7–A8 of ED-220).
13. In certain places in ED-220, the engagement partner or engagement team is required to comply with the firm's policies or procedures in addressing the requirements of ED-220. This is because in such cases the firm's policies or procedures are considered integral to the fulfillment of the requirements of ED-220. For example, paragraph 16 of ED-220 requires the engagement partner to evaluate threats to compliance with relevant ethical requirements through complying with the firm's policies or procedures. Complying with the firm's policies or procedures in these circumstances is considered necessary because the engagement partner would likely not have the necessary information or tools to evaluate the threats, and would therefore need to draw upon the firm's resources to assist in this regard. The IAASB concluded that the requirements that reference the firm's policies and procedures are aligned with requirements in proposed ISQM 1 for the firm to establish responses to risks to

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<sup>3</sup> See [ED-ISQM 1](#).

<sup>4</sup> See the [overall explanatory memorandum](#) for an explanation of how the quality management approach can be implemented in a scalable manner and the implementation support tools available.

<sup>5</sup> See [ED-ISQM 2](#).

engagement quality<sup>6</sup> and this approach is consistent with extant ISA 220. In addition, understanding and complying at the engagement level with applicable firm policies and procedures is critical to establishing and maintaining the relationship between quality management at the firm level and quality management at the engagement level.

14. In ED-220, the phrase “shall be satisfied” has been used in requirements that refer to the engagement partner’s responsibility in relation to actions that occur (or should have occurred) at the firm level, but which are relevant to managing and achieving quality at the engagement level. The phrase “shall determine” has been used in requirements that refer directly to actions that the engagement partner is required to take.

*Scalability for Firms of Different Sizes and for Engagements Where Nature and Circumstances Differ*

15. ED-220 is intended to be applied by firms of all sizes and circumstances and it is intended to be scalable based on the nature and circumstances of the audit engagement. The Appendix to this Explanatory Memorandum lists paragraphs that highlight how the proposed ISA can be applied in the different circumstances. In addition, the IAASB is developing support materials to show how certain aspects of proposed ISA 220 (Revised) and ISQM 1 (Revised) can be applied together in a scalable manner in smaller firms.<sup>7</sup>

**Section 2-B – The Engagement Partner’s Overall Responsibility for Managing and Achieving Quality on Audits, Including Engagement Performance and Standing Back**

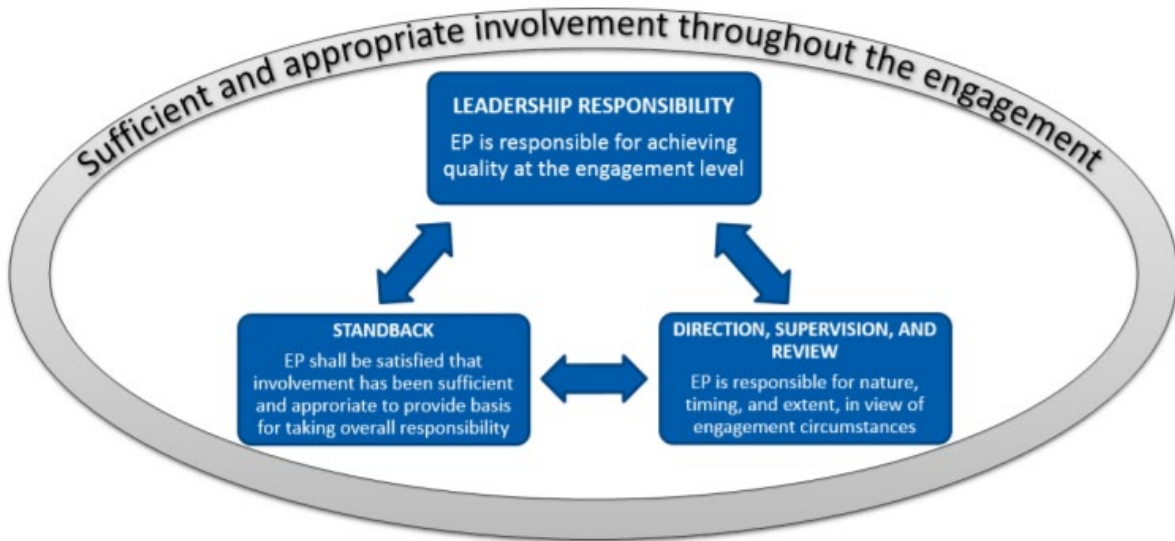
16. Extant ISA 220 requires the engagement partner to take responsibility for the overall quality of each audit engagement to which that partner is assigned and provides guidance on the actions and messages to emphasize. The ITC noted that the project to revise ISA 220 may result in updating requirements and application material in ISA 220 to make the engagement partner’s responsibilities for leadership and project management (including the assessment of the competence and objectivity of the engagement team) more explicit.
17. The IAASB believes that the engagement partner needs to be sufficiently and appropriately involved throughout the engagement as this is fundamental to providing the engagement leadership required to achieve high quality audits and, therefore, to meeting the objective of ISA 220. The diagram below illustrates how the engagement partner’s overall responsibility to manage and achieve quality on the engagement is demonstrated through sufficient and appropriate involvement throughout the engagement, such that the significant judgments made and the conclusions reached are appropriate given the nature and circumstances of the audit. This overall responsibility includes:
  - a) **Fulfilling leadership responsibilities**, including taking actions to create an environment for the engagement that emphasizes the firm’s culture and the expected behavior of engagement team members, and assigning procedures, tasks or actions to other members of the engagement team;
  - b) **Supporting engagement performance**, including taking responsibility for the nature, timing and extent of direction, supervision and review of the work performed; and

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<sup>6</sup> See Section 6 of the Explanatory Memorandum, *The IAASB’s Exposure Drafts for Quality Management at the Firm and Engagement Level, Including Engagement Quality Reviews*.

<sup>7</sup> The support materials will be available at [www.iaasb.org](http://www.iaasb.org) during the public exposure period for ED-220.

- c) **Standing back**, to determine whether the engagement partner has taken overall responsibility for managing and achieving quality, including determining that the engagement partner's involvement has been sufficient and appropriate throughout the engagement and that the nature and circumstances of the engagement have been taken into account.



*Fulfilling Leadership Responsibilities (Paragraphs 11–13 of ED-220)*

18. In clarifying the role and responsibilities of the engagement partner, the IAASB determined that ED-220 needed to highlight early in the ISA that achieving quality on the audit engagement requires the engagement partner to demonstrate sufficient and appropriate involvement in the engagement, which includes being responsible for creating an environment that emphasizes the firm's culture and expected behavior of engagement team members (see paragraph 11 of ED-220). The engagement partner is also required to take clear, consistent and effective actions that reflect the firm's commitment to quality and communicate the expected behavior of engagement team members (see paragraph 12 of ED-220). The focus on the link between the firm's culture and the tone set by leadership is aligned with the requirements of ED-ISQM 1 (see, for example, paragraph 22 of the explanatory memorandum of ED-ISQM 1).
19. Another aspect of leadership responsibilities is assigning responsibilities to other engagement team members. ED-220 recognizes that the engagement partner may assign procedures, tasks or actions to other members of the engagement team to assist the engagement partner in complying with the requirements, but that the engagement partner is still required to take overall responsibility for the quality of the engagement. The engagement partner is therefore required to inform assignees about their responsibilities, to monitor the performance of the assignees' work, and to review related documentation (see paragraph 13 of ED-220). The IAASB discussed whether the leadership requirements, collectively, placed too much emphasis on the role of the engagement partner, but concluded that the public interest was best served by requirements that continue to emphasize the importance of overall responsibility for managing and achieving quality being in the hands of the engagement partner.

*Supporting Engagement Performance* (Paragraphs 27–31 of ED-220)

20. The IAASB revised the engagement performance section extensively to improve the quality of audits by enhancing the requirements and emphasizing the importance of taking the nature and circumstances of the audit into account in addressing them. To this end:
- The requirements and application material on direction, supervision and review have been strengthened and include greater specificity on how the engagement partner needs to be involved. In addition, the revised requirements include linkages with other requirements in ED-220 (e.g. the requirements on engagement resources) and with other ISAs (e.g. the guidance in ISA 230 on significant matters). The proposed standard also includes new guidance on these requirements, including guidance on matters that may constitute a significant judgment, and which matters therefore need to be reviewed by the engagement partner.
  - New requirements require the engagement partner to review the financial statements and the auditor’s report prior to dating the auditor’s report and, prior to their issuance, to review formal written communications to management, those charged with governance, or regulatory authorities.
  - The proposed ISA includes improved links with proposed ISQM 1 and ISQM 2, for example:
    - Requiring the engagement partner to take responsibility for the engagement team consulting on matters where the firm’s policies or procedures require consultation.
    - Aligning the requirement to cooperate with the engagement quality reviewer with proposed ISQM 2.
    - Referring in paragraph A29 of ED-ISQM 2 to the new focus and guidance on significant judgments in ED-220, which provides assistance to the engagement quality reviewer in addressing the requirements of ISQM 2
  - A new requirement on addressing differences of opinion has been included to provide greater specificity on the engagement partner’s role in handling differences of opinion. This requirement is supported by guidance on how to handle differences of opinion.

*Standing Back* (Paragraph 37 of ED-220)

21. Paragraph 37 of ED-220 requires the engagement partner to “stand-back” and, prior to forming an opinion, determine that the engagement partner has taken overall responsibility for managing and achieving quality on the audit engagement. The IAASB concluded that it was appropriate for the engagement partner to determine that the engagement partner’s involvement has been sufficient and appropriate throughout the audit engagement and that the nature and circumstances of the engagement (and any changes thereto) have been taken into account in complying with the proposed ISA. The IAASB believes that including such a stand-back requirement would also assist in supporting the exercise of professional skepticism by the engagement partner and other members of the engagement team. Paragraph A100 of ED-220 provides guidance that appropriate consideration of the requirements of ED-220, and how the audit documentation evidences the engagement partner’s involvement in the audit, would provide the basis for whether the engagement partner has taken overall responsibility for managing and achieving quality.

**Section 2-C – Relevant Ethical Requirements**

22. Extant ISA 220 requires that the engagement partner remain alert for non-compliance with relevant ethical requirements by members of the engagement team, determine the appropriate action if non-compliance comes to the engagement partner's attention, and conclude on compliance with independence requirements. The ITC noted that ISA 220 could include further material on the responsibilities of the engagement partner in relation to relevant ethical requirements for members of the engagement team.
23. In response to the ITC and the comments thereon, the IAASB determined that the requirements should be strengthened regarding relevant ethical requirements and the engagement partner's role in dealing with relevant ethical requirements. Accordingly, in addition to enhancing the extant requirements, ED-220 includes requirements regarding:
- Understanding of the relevant ethical requirements and whether other members of the engagement team are aware of those requirements and the firm's related policies or procedures;
  - Threats to compliance with relevant ethical requirements; and
  - Determining whether relevant ethical requirements, including those related to independence, have been fulfilled.
24. ED-220 also includes new application material that links with the firm level requirements in proposed ISQM 1, describes possible appropriate actions if non-compliance is indicated, and links to the requirement in ISA 700 (Revised)<sup>8</sup> for the auditor's report to include a statement regarding the auditor's independence.

**Section 2-D – Engagement Resources**

25. Extant ISA 220 contains requirements and guidance about the assignment of the engagement team, but does not otherwise address the engagement level resources. In paragraph 78 of the ITC, it was noted that extant ISA 220 does not explicitly address the need for the engagement partner to be satisfied that sufficient time and resources are available to the engagement team such that it will be possible to perform the necessary work to obtain sufficient appropriate audit evidence before the reporting deadline.
26. Consistent with the approach taken in ED-ISQM 1, proposed ISA 220 addresses this gap through a new section on human, technological and intellectual resources (see paragraphs 23–26 of ED-220). The engagement partner is responsible for determining that there are sufficient and appropriate resources assigned or made available on a timely basis. The engagement partner is also responsible for taking appropriate action when insufficient or inappropriate resources in the context of the audit engagement are provided by the firm, and for the appropriate use of resources by the engagement team. New application material describes how human, technological, and intellectual resources may be used to support the performance of audit engagements, how project management skills can assist in managing the quality of the audit engagement, and the appropriate actions if the engagement partner determines that the resources are insufficient or inappropriate.

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<sup>8</sup> ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, paragraph 28(c)

## Section 2-E – Other Matters

27. Other improvements in ED-220 include that:

- Information learned in the acceptance and continuance process is required to be taken into account in planning and performing the audit engagement in accordance with the ISAs (see paragraph 21 of ED-220). For example, ED-220 now explicitly recognizes that information obtained in the acceptance and continuance process will be relevant to the auditor's risk assessment process.
- The monitoring and remediation requirement has been enhanced and clarified. The IAASB has also aligned ED-220 with the new requirements in proposed ISQM 1, and are premised on the basis that the engagement partner is responsible for dealing with the relevant aspects of the monitoring and remediation process as communicated by the firm, including, as applicable, the results of the monitoring and remediation process of the network or network firms (see paragraph 36 of ED-220). In addition, the engagement partner is also required to be satisfied that the engagement team is aware of the results of the firm's monitoring and remediation process, and to remain alert throughout the engagement for information that may be relevant to the monitoring and remediation approach.

28. Regardless of how the engagement team is organized, the IAASB has also emphasized the engagement partner's overall responsibility for managing and achieving quality on the engagement (see Section 2-B above). In light of this, the role and responsibilities of the engagement partner and engagement team in a group audit are also a key focus for the IAASB. The IAASB is currently undertaking a project to revise ISA 600,<sup>9</sup> which may result in minor amendments to ED-220 in due course as the project progresses.

## Section 3 Request for Comments

Respondents are asked to comment on the clarity, understandability and practicality of application of the requirements and related application material of ED-220. In this regard, comments will be most helpful if they are identified with specific aspects of ED-220 and include the reasons for any concern about clarity, understandability and practicality of application, along with suggestions for improvement.

- 1) Do you support the focus on the sufficient and appropriate involvement of the engagement partner (see particularly paragraphs 11–13 and 37 of ED-220), as part of taking overall responsibility for managing quality on the engagement? Does the proposed ISA appropriately reflect the role of other senior members of the engagement team, including other partners?
- 2) Does ED-220 have appropriate linkages with the ISQMs? Do you support the requirements to follow the firm's policies and procedures and the material referring to when the engagement partner may depend on the firm's policies or procedures?
- 3) Do you support the material on the appropriate exercise of professional skepticism in managing quality at the engagement level? (See paragraph 7 and A27–A29 of ED-220)
- 4) Does ED-220 deal adequately with the modern auditing environment, including the use of different audit delivery models and technology?
- 5) Do you support the revised requirements and guidance on direction, supervision and review? (See paragraphs 27–31 and A68–A80 of ED-220)

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<sup>9</sup> ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

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- 6) Does ED-220, together with the overarching documentation requirements in ISA 230, include sufficient requirements and guidance on documentation?
- 7) Is ED-220 appropriately scalable to engagements of different sizes and complexity, including through the focus on the nature and circumstances of the engagement in the requirements?



**Scalability for Firms of Different Sizes and for Engagements Where Nature and Circumstances Differ**

Note: This Appendix includes the relevant references to the material located within ED-220 that incorporates scalability for firms of different sizes and for engagements where the nature and circumstances differ.

How ED-220 Covers Scalability	Reference to ED-220
<ul style="list-style-type: none"> <li>• In larger firms, responsibility for elements of the system of quality management is dispersed throughout the firm and the engagement partner may not have direct involvement or detailed knowledge of those elements. In such cases, the engagement partner may use information provided by the firm and personal knowledge, supplemented with additional inquiries or other procedures, to have the necessary basis to depend on the firm’s policies and procedures. In a smaller firm, the engagement partner may have more direct involvement in the firm’s processes, which may provide the basis for depending on the firm’s policies or procedures in certain circumstances.</li> <li>• For example, if the engagement partner is directly involved throughout the firm’s acceptance and continuance process, the engagement partner will therefore be aware of the information obtained, or used by the firm, in reaching the related conclusions. Such involvement may also therefore provide a basis for the engagement partner being satisfied that the firm’s policies or procedures have been followed and that the conclusions reached are appropriate.</li> </ul>	<ul style="list-style-type: none"> <li>• The Firm’s System of Quality Management and Role of Engagement Teams – Paragraphs A7–A8.</li> <li>• Acceptance and Continuance of Client Relationships and Audit Engagements – Paragraph A45.</li> <li>• Engagement Resources – Paragraphs A52 and A61.</li> </ul>

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How ED-220 Covers Scalability	Reference to ED-220
<ul style="list-style-type: none"> <li>• In a smaller firm, the design and implementation of many responses to the firm’s quality risks may be most effectively dealt with by the engagement partner at the engagement level.</li> <li>• The firm’s responses to quality risks, including policies or procedures, may be less formal in a smaller firm (e.g., in a very small firm with a relatively small number of audit engagements, firm leadership may determine that there is no need to establish a firm-wide system to monitor independence, and rather, independence would be monitored at the engagement level by the engagement partner).</li> </ul>	<ul style="list-style-type: none"> <li>• The Firm’s System of Quality Management and Role of Engagement Teams – Paragraph A14.</li> </ul>
<ul style="list-style-type: none"> <li>• Some requirements of ED-220 may not be relevant if the audit is carried out entirely by the engagement partner because they are conditional on the involvement of other members of the engagement team (e.g., requirements related to direction, supervision, and review).</li> </ul>	<ul style="list-style-type: none"> <li>• The Firm’s System of Quality Management and Role of Engagement Teams – Paragraph A15.</li> </ul>
<ul style="list-style-type: none"> <li>• For a smaller engagement team that consists of only a few engagement team members, the engagement partner’s actions influence the desired culture through direct interaction and conduct, which may be sufficient to reflect the firm’s commitment to quality. For a larger engagement team that is dispersed over many locations, more formal communications may be necessary.</li> </ul>	<ul style="list-style-type: none"> <li>• Leadership Responsibilities for Managing and Achieving Quality on Audits – Paragraph A23.</li> </ul>
<ul style="list-style-type: none"> <li>• The requirements relating to nature, timing and extent of direction and supervision of the members of the engagement team and the review of the work performed are required to be responsive to the nature and circumstances of the audit engagement and the resources assigned or made available to the engagement (i.e., the direction, supervision and review is to be specifically</li> </ul>	<ul style="list-style-type: none"> <li>• Engagement Performance – Paragraphs 27–29.</li> </ul>

EXPLANATORY MEMORANDUM

How ED-220 Covers Scalability	Reference to ED-220
<p>tailored or scaled for each engagement, depending on its size and complexity).</p>	
<ul style="list-style-type: none"> <li>For larger engagements, the engagement partner may assign certain procedures, tasks or other actions to other members of the engagement team to assist the engagement partner in complying with the requirements of ED-220.</li> </ul>	<ul style="list-style-type: none"> <li>Leadership Responsibilities for Managing and Achieving Quality on Audits – Paragraphs 13 and A30.</li> </ul>
<ul style="list-style-type: none"> <li>In situations where there are many engagement team members, for example on larger or more complex audit engagements, the engagement partner may involve an individual who has specialized skills or knowledge in project management, supported by appropriate technological and intellectual resources of the firm. Conversely, for a smaller engagement team with fewer engagement team members, project management may be achieved through less formal means.</li> </ul>	<ul style="list-style-type: none"> <li>Engagement Resources – Paragraph A63–A64.</li> </ul>
<ul style="list-style-type: none"> <li>Explicit acknowledgement of a tailored approach to quality management at the engagement level that is responsive to the nature and circumstances of the audit engagement.</li> </ul>	<ul style="list-style-type: none"> <li>Scope of this ISA – Paragraph A2.</li> <li>The Firm’s System of Quality Management and Role of Engagement Teams – Paragraphs 4(b), 7, A5, A9, and A14.</li> <li>Relevant Ethical Requirements, Including Independence Requirements – Paragraphs 14–15, 18, and A32–A33.</li> <li>Acceptance and Continuance of Client Relationships and Audit Engagements – Paragraph A49.</li> <li>Leadership Responsibilities for Managing and Achieving Quality on Audits – Paragraphs 11, A23–A24, and A66.</li> <li>Engagement Resources – Paragraphs 23, 25, A52, A60, and A11D.</li> <li>Direction, Supervision and Review – Paragraphs 27(b), A69, A81, and A84.</li> <li>Monitoring and Remediation – Paragraph A97.</li> </ul>

EXPLANATORY MEMORANDUM

<b>How ED-220 Covers Scalability</b>	<b>Reference to ED-220</b>
	<ul style="list-style-type: none"><li>• Taking Overall Responsibility for Managing and Achieving Quality – Paragraph 37.</li></ul>

**PROPOSED INTERNATIONAL STANDARD ON AUDITING 220  
(REVISED)  
QUALITY MANAGEMENT FOR AN AUDIT OF FINANCIAL  
STATEMENTS**

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## Introduction

### Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the specific responsibilities of the auditor regarding quality management at the engagement level for an audit of financial statements, and the related responsibilities of the engagement partner. This ISA is to be read in conjunction with relevant ethical requirements. (Ref: Para. A1–A2)

### The Firm's System of Quality Management and Role of Engagement Teams

2. The firm is responsible for the system of quality management. Under proposed ISQM 1, the objective of the firm is to design, implement and operate a system of quality management for audits or reviews of financial statements, or other assurance or related services engagements performed by the firm, that provides the firm with reasonable assurance that:
  - (a) The firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements; and
  - (b) Engagement reports issued by the firm or engagement partners are appropriate in the circumstances.<sup>10</sup> (Ref: Para. A3, A14–A15)
3. This ISA is premised on the basis that the firm is subject to the ISQMs or to national requirements that are at least as demanding. (Ref: Para. A4)
4. The engagement team, led by the engagement partner, is responsible, within the context of the firm's system of quality management and through complying with the requirements of this ISA, for:
  - (a) Implementing the firm's responses to quality risks (i.e., the firm's policies or procedures) that are applicable to the audit engagement using information communicated by, or obtained from, the firm; (Ref: Para. A5–A8)
  - (b) Given the nature and circumstances of the audit engagement, determining whether to design and implement responses beyond those set forth in the firm's policies or procedures; and (Ref: Para. A9–A10)
  - (c) Providing the firm with information from the audit engagement to support the design, implementation, and operation of the firm's system of quality management that is required to be communicated in accordance with the firm's policies or procedures. (Ref: Para. A11)
5. Complying with the requirements in other ISAs may provide information that is relevant to quality management at the engagement level. (Ref: Para. A12)
6. The public interest is served by the consistent performance of quality audit engagements. Quality audit engagements are achieved through planning and performing engagements and reporting on them in accordance with professional standards and applicable legal and regulatory requirements. Achieving the objectives of those standards and complying with the requirements of applicable law

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<sup>10</sup> Proposed ISQM 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*, paragraph 21

or regulation involves exercising professional judgment and exercising professional skepticism. (Ref: Para. A13)

7. In accordance with ISA 200,<sup>11</sup> the engagement partner and other members of the engagement team are required to plan and perform an audit with professional skepticism and to exercise professional judgment. In doing so, the engagement partner and engagement team exercise professional judgment and professional skepticism in meeting the objective and requirements of this ISA. Professional judgment is applied in making informed decisions about the courses of action that are appropriate to manage and achieve quality given the nature and circumstances of the audit engagement. Professional skepticism supports the quality of judgments made by the engagement team and, through these judgments, supports the overall effectiveness of the engagement team in achieving quality at the engagement level. The appropriate exercise of professional skepticism may be demonstrated through the actions and communications of the engagement partner and other members of the engagement team. Such actions and communications may include specific steps to deal with impediments that may impair the appropriate exercise of professional skepticism, such as unconscious bias or resource constraints. (Ref: Para. A27–A29)

### Effective Date

8. This ISA is effective for audits of financial statements for periods beginning on or after [Date].

### Objective

9. The objective of the auditor is to manage quality at the engagement level to obtain reasonable assurance that quality has been achieved such that:
- (a) The auditor has fulfilled the auditor’s responsibilities, and has conducted the audit, in accordance with professional standards and applicable legal and regulatory requirements; and
  - (b) The auditor’s report issued is appropriate in the circumstances.

### Definitions

10. For purposes of the ISAs, the following terms have the meanings attributed below:
- (a) Engagement partner<sup>12</sup> – The partner, or other individual appointed by the firm, who is responsible for the audit engagement and its performance, and for the auditor’s report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.
  - (b) Engagement quality review – An objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon that is completed on or before the date of the engagement report.
  - (c) Engagement quality reviewer – A suitably qualified partner or other individual appointed by the firm to be responsible for the performance of the engagement quality review.

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<sup>11</sup> ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, paragraphs 15–16

<sup>12</sup> “Engagement partner,” “partner,” and “firm” should be read as referring to their public sector equivalents where relevant.



- (d) Engagement team – All partners and staff performing the audit engagement, and any other individuals who perform audit procedures on the engagement, including individuals engaged by the firm or a network firm. The engagement team excludes an auditor’s external expert engaged by the firm or a network firm,<sup>13</sup> and also excludes individuals within the client’s internal audit function who provide direct assistance on an engagement when the external auditor complies with the requirements of ISA 610 (Revised 2013).<sup>14</sup> (Ref: Para. A16–A19)
- (e) Firm – A sole practitioner, partnership or corporation or other entity of professional accountants, or public sector equivalent. (Ref: Para. A20)
- (f) Network firm – A firm or entity that belongs to a network. (Ref: Para. A21)
- (g) Network – A larger structure: (Ref: Para. A21)
  - (i) That is aimed at cooperation, and
  - (ii) That is clearly aimed at profit or cost-sharing or shares common ownership, control or management, common quality management policies or procedures, common business strategy, the use of a common brand name, or a significant part of professional resources.
- (h) Partner – Any individual with authority to bind the firm with respect to the performance of a professional services engagement.
- (i) Personnel – Partners and staff.
- (j) Professional standards – International Standards on Auditing (ISAs) and relevant ethical requirements.
- (k) Relevant ethical requirements – Principles of professional ethics and ethical requirements that are applicable to professional accountants when undertaking the audit engagement. Relevant ethical requirements ordinarily comprise the provisions of the International Ethics Standards Board for Accountants’ *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA Code) related to audits of financial statements, together with national requirements that are more restrictive.
- (l) Response (in relation to a system of quality management) – Policies or procedures designed and implemented by the firm to address a quality risk:
  - (i) Policies are statements of what should, or should not, be done to address a quality risk. Such statements may be documented, explicitly stated in communications or implied through actions and decisions.
  - (ii) Procedures are actions to implement policies.
- (m) Staff – Professionals, other than partners, including any experts the firm employs.

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<sup>13</sup> ISA 620, *Using the Work of an Auditor’s Expert*, paragraph 6(a), defines the term “auditor’s expert.”

<sup>14</sup> ISA 610 (Revised 2013), *Using the Work of Internal Auditors*, establishes limits on the use of direct assistance. It also acknowledges that the external auditor may be prohibited by law or regulation from obtaining direct assistance from internal auditors. Therefore, the use of direct assistance is restricted to situations where it is permitted.

## Requirements

### Leadership Responsibilities for Managing and Achieving Quality on Audits

11. The engagement partner shall take overall responsibility for managing and achieving quality on the audit engagement, including taking responsibility for creating an environment for the engagement that emphasizes the firm's culture and expected behavior of engagement team members. In doing so, the engagement partner shall be sufficiently and appropriately involved throughout the engagement such that the engagement partner has the basis for determining whether the significant judgments made and the conclusions reached are appropriate given the nature and circumstances of the engagement. (Ref: Para. A22–A29)
12. In creating the environment described in paragraph 11, the engagement partner, and others to whom supervisory roles are assigned, shall take clear, consistent and effective actions that reflect the firm's commitment to quality and establish and communicate the expected behavior of engagement team members, including:
  - (a) Emphasizing that all engagement team members are responsible for contributing to the management and achievement of quality at the engagement level;
  - (b) Reinforcing the importance of professional ethics, values, and attitudes to the members of the engagement team;
  - (d) Encouraging open and robust communication within the engagement team, and supporting the ability of engagement team members to raise concerns without fear of reprisal; and
  - (e) Emphasizing the importance of each engagement team member exercising professional skepticism throughout the audit engagement.
13. If the engagement partner assigns procedures, tasks or actions to other members of the engagement team to assist the engagement partner in complying with the requirements of this ISA, the engagement partner shall continue to take overall responsibility for managing and achieving quality on the audit engagement. When assigning procedures, tasks or actions to other members of the engagement team, the engagement partner shall: (Ref: Para. A30)
  - (a) Appropriately inform assignees about the nature of their responsibilities and authority, the scope of the work being assigned, the objectives thereof and any other necessary instructions and relevant information; and
  - (b) Monitor the performance of the work of assignees and review selected related documentation in order to evaluate the conclusions reached.

### Relevant Ethical Requirements, Including Those Related to Independence

14. The engagement partner shall have an understanding of the relevant ethical requirements, including those related to independence, that are applicable given the nature and circumstances of the audit engagement. (Ref: Para. A31–A35, A41)
15. The engagement partner shall determine that other members of the engagement team have been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the audit engagement, and the firm's related policies or procedures, including those that deal with: (Ref: Para. A33–A35)

- (a) Identifying, evaluating, and addressing threats to compliance with relevant ethical requirements, including those related to independence;
  - (b) Circumstances that may cause a breach of relevant ethical requirements, including those related to independence, and their responsibilities when they become aware of actual or suspected breaches; and
  - (c) Their responsibilities when they become aware of an instance of actual or suspected non-compliance with laws and regulations.<sup>15</sup>
16. If matters come to the engagement partner's attention that indicate that a threat to compliance with relevant ethical requirements exists, the engagement partner shall evaluate such threats through complying with the firm's policies or procedures, using relevant information from the firm, the engagement team, or other sources and take appropriate action. (Ref: Para. A36–A37)
17. The engagement partner shall remain alert throughout the audit engagement, through observation and making inquiries as necessary, for actual or suspected breaches of relevant ethical requirements or the firm's related policies or procedures by members of the engagement team. (Ref: Para. A38)
18. If matters come to the engagement partner's attention through the firm's system of quality management, or from other sources, that indicate that relevant ethical requirements applicable to the nature and circumstances of the audit engagement have not been fulfilled, the engagement partner, in consultation with others in the firm, shall take appropriate action. (Ref: Para. A39)
19. Prior to dating the auditor's report, the engagement partner shall determine whether relevant ethical requirements, including those related to independence, have been fulfilled. (Ref: Para. A40)

#### **Acceptance and Continuance of Client Relationships and Audit Engagements**

20. The engagement partner shall be satisfied that the firm's policies or procedures for the acceptance and continuance of client relationships and audit engagements have been followed, and shall determine that conclusions reached in this regard are appropriate. (Ref: Para. A42–A45, A51)
21. The engagement partner shall take into account information obtained in the acceptance and continuance process in planning and performing the audit engagement in accordance with the ISAs and complying with the requirements of this ISA. (Ref: Para. A46–A49)
22. If the engagement partner obtains information that may have caused the firm to decline the audit engagement had that information been known by the firm prior to accepting or continuing the client relationship or specific engagement, the engagement partner shall communicate that information promptly to the firm, so that the firm and the engagement partner can take the necessary action. (Ref: Para. A50)

#### **Engagement Resources**

23. The engagement partner shall determine that, given the nature and circumstances of the audit engagement (and any changes that may arise during its course), sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team by the firm on a timely basis. (Ref: Para. A52–A61, A63–A64, A67)

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<sup>15</sup> ISA 250 (Revised), *Considerations of Laws and Regulations in an Audit of Financial Statements*

24. The engagement partner shall determine that members of the engagement team, and any auditor's experts who are not part of the engagement team, collectively have the appropriate competence and capabilities, including sufficient time, to perform the audit engagement. (Ref: Para. A62–A64)
25. If, as a result of complying with the requirement in paragraphs 23 and 24, the engagement partner determines that resources assigned or made available by the firm are insufficient or inappropriate in the circumstances of the audit engagement, the engagement partner shall take appropriate action, including communicating with appropriate personnel in the firm about the need to allocate or assign additional or alternative resources to the engagement. (Ref: Para. A65–A66)
26. The engagement partner shall take responsibility for using the resources assigned or made available to the engagement team appropriately, given the nature and circumstances of the audit engagement. (Ref: Para. A58)

### **Engagement Performance**

#### *Direction, Supervision and Review*

27. The engagement partner shall take responsibility for the nature, timing and extent of direction and supervision of the members of the engagement team and the review of the work performed, and determine that such direction, supervision and review is: (Ref: Para A68–A76, A81–A83)
  - (a) Planned and performed in accordance with the firm's policies or procedures, professional standards and applicable legal and regulatory requirements;
  - (b) Responsive to the nature and circumstances of the audit engagement and the resources assigned or made available to the engagement; and
  - (c) Planned and performed on the basis that the work performed by less experienced team members is directed, supervised, and reviewed by more experienced engagement team members.
28. On or before the date of the auditor's report, the engagement partner shall, through review of audit documentation and discussion with the engagement team, determine that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued. (Ref: Para. A77–A80)
29. In complying with the requirements of paragraph 28, the engagement partner shall review audit documentation at appropriate points in time during the audit engagement, including audit documentation relating to: (Ref: Para. A77–A80)
  - (a) Significant matters;<sup>16</sup>
  - (b) Other areas involving significant judgments, especially those relating to difficult or contentious matters identified during the course of the engagement, and the conclusions reached; and
  - (c) Other matters that, in the engagement partner's professional judgment, are relevant to the engagement partner's responsibilities.
30. Prior to dating the auditor's report, and in order to determine that the report to be issued will be appropriate in the circumstances, the engagement partner shall review the financial statements and

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<sup>16</sup> ISA 230, *Audit Documentation*, paragraph 8

the auditor's report, including, if applicable, the description of the key audit matters<sup>17</sup> and related audit documentation.

31. The engagement partner shall review, prior to their issuance, any formal written communications to management, those charged with governance, or regulatory authorities.

#### *Consultation*

32. The engagement partner shall: (Ref: Para. A84–A87)
- (a) Take responsibility for the engagement team undertaking consultation on:
    - (i) Matters where the firm's policies or procedures require consultation, including on difficult or contentious matters; and
    - (ii) Other matters that in the engagement partner's professional judgment, require consultation;
  - (b) Determine that members of the engagement team have undertaken appropriate consultation during the course of the audit engagement, both within the engagement team, and between the engagement team and others at the appropriate level within or outside the firm;
  - (c) Determine that the nature and scope of, and conclusions resulting from, such consultations are agreed with the party consulted; and
  - (d) Determine that conclusions resulting from such consultations have been implemented.

#### *Engagement Quality Review*

33. For audit engagements for which an engagement quality review is required, the engagement partner shall: (Ref: Para. A88)
- (a) Be satisfied that an engagement quality reviewer has been appointed;
  - (b) Cooperate with the engagement quality reviewer and inform other members of the engagement team of their responsibility to do so;
  - (c) Discuss significant matters arising during the engagement, including those identified during the engagement quality review, with the engagement quality reviewer; and
  - (d) Not date the auditor's report until the completion of the engagement quality review. (Ref: Para. A89–A92)

#### *Differences of Opinion*

34. If differences of opinion arise, within the engagement team, or between the engagement team and the engagement quality reviewer or personnel performing activities within the firm's system of quality management, including those who provide consultation, the engagement team shall follow the firm's policies or procedures for dealing with and resolving them. (Ref: Para. A93–A94)
35. The engagement partner shall:
- (a) Take responsibility for differences of opinion being dealt with and resolved in accordance with the firm's policies or procedures;

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<sup>17</sup> ISA 701, *Communicating Key Audit Matters in the Auditor's Report*

- (b) Determine that conclusions reached are documented and implemented; and
- (c) Not date the auditor's report until any differences of opinion are resolved.

### **Monitoring and Remediation**

36. The engagement partner shall: (Ref: Para. A97–A98)
- (a) Be satisfied that the engagement team has been made aware of results of the firm's monitoring and remediation process, as communicated by the firm including, as applicable, the results of the monitoring and remediation process of the network or network firms;
  - (b) Determine the relevance and effect on the audit engagement of the information referred to in paragraph 36(a) and take appropriate action; and
  - (c) Remain alert throughout the audit engagement for information that may be relevant to the firm's monitoring and remediation process and communicate such information to those responsible for the process.

### **Taking Overall Responsibility for Managing and Achieving Quality**

37. Prior to dating the auditor's report, the engagement partner shall determine that the engagement partner has taken overall responsibility for managing and achieving quality on the audit engagement. In doing so, the engagement partner shall determine that: (Ref: Para. A99–A101)
- (a) The engagement partner's involvement has been sufficient and appropriate throughout the audit engagement such that the engagement partner has the basis for determining that the significant judgments made and the conclusions reached are appropriate given the nature and circumstances of the engagement; and
  - (b) The nature and circumstances of the audit engagement, any changes thereto, and the firm's related policies or procedures, have been taken into account in complying with the requirements of this ISA.

### **Documentation**

38. The auditor shall include in the audit documentation:<sup>18</sup> (Ref: Para. A102–A104)
- (a) Matters identified, relevant discussions with firm personnel, and conclusions reached with respect to:
    - (i) Fulfillment of responsibilities relating to relevant ethical requirements, including those related to independence.
    - (ii) The acceptance and continuance of the client relationship and audit engagement.
  - (b) The nature and scope of, and conclusions resulting from, consultations undertaken during the course of the audit engagement and how such conclusions were implemented.
  - (c) If the audit engagement is subject to an engagement quality review, that the engagement quality review has been completed on or before the date of the auditor's report.

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<sup>18</sup> ISA 230, paragraphs 8-11 and A6

## Application and Other Explanatory Material

### Scope of this ISA (Ref: Para. 1)

- A1. This ISA applies to all audits of financial statements, including audits of group financial statements. ISA 600,<sup>19</sup> deals with special considerations that apply to group audits, in particular those that involve component auditors.
- A2. ISA 200 requires the auditor to comply with relevant ethical requirements, including those related to independence, relating to financial statement audit engagements.<sup>20</sup> Paragraphs 14–19 and A31–A41 of this ISA include requirements and guidance that deal with complying with relevant ethical requirements that are applicable given the nature and circumstances of the engagement, including those related to independence.

### The Firm's System of Quality Management and Role of Engagement Teams (Ref: Para. 2 – 5)

- A3. Proposed ISQM 1 deals with a firm's responsibilities for its system of quality management. A system of quality management is designed, implemented and operated by a firm in accordance with proposed ISQM 1 and is organized into the following eight components:
- Governance and leadership;
  - The firm's risk assessment process;
  - Relevant ethical requirements;
  - Acceptance and continuance of client relationships and specific engagements;
  - Engagement performance;
  - Resources;
  - Information and communication; and
  - The monitoring and remediation process.
- A4. Firms or national requirements may use different terminology or frameworks to describe components of a system of quality management. National requirements that deal with the firm's responsibilities to design, implement, and operate a system of quality management are at least as demanding as proposed ISQM 1 when they deal with all the components referred to in paragraph A3 and impose obligations on the firm to achieve the objective set out in proposed ISQM 1.

### Implementing the Firm's Responses to Quality Risks That Are Applicable to the Audit Engagement (Ref: Para. 4(a))

- A5. Quality management at the engagement level is supported by the firm's system of quality management and informed by the specific nature and circumstances of the audit engagement. In accordance with proposed ISQM 1, the firm is responsible for communicating to relevant personnel, including the engagement team, about their responsibilities for implementing the firm's responses that are

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<sup>19</sup> ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

<sup>20</sup> ISA 200, paragraph 14.

applicable at the engagement level. For example, such firm level responses may include policies or procedures to undertake consultations with designated personnel in certain situations involving complex technical or ethical matters, or to involve firm-designated experts in specific engagements to deal with particular matters (e.g., the firm may specify that firm-designated credit experts are to be involved in auditing credit loss allowances in all audits of financial institutions).

- A6. Firm level responses may include policies or procedures established by a network, or by another firm or group of firms within the same network (network requirements or network services are described further in proposed ISQM 1 within the “Network Requirements or Network Services” section). The requirements of this ISA are based on the premise that the firm is responsible for taking the necessary action to enable engagement teams to implement or use network resources or services or the work of network resources or services on the audit engagement.

#### Other Firm Level Responses That May be Relevant to the Engagement Team (Ref: Para. 4(a))

- A7. Some firm level responses to quality risks are not performed at the engagement level but are nevertheless relevant when complying with the requirements of this ISA. For example, when determining whether the members of the engagement team collectively have the appropriate competence and capabilities to perform the audit engagement, the engagement partner may be able to depend on the firm’s policies or procedures dealing with personnel recruitment and professional training. Other examples of firm level responses that the engagement partner may be able to depend on when complying with the requirements of this ISA include:

- Information systems that monitor independence;
- Information systems that deal with acceptance and continuance of client relationships and audit engagements; and
- Audit methodologies and related implementation tools and guidance.

- A8. Matters that the engagement partner may take into account when determining whether, and if so, the degree to which, the engagement partner may depend on the firm’s policies or procedures in complying with the requirements of this ISA include:

- The engagement partner’s knowledge or understanding of, or practical experience with, such policies or procedures.
- Information obtained from the firm, engagement team, or other parties, about the effectiveness of such policies or procedures (e.g., information provided by the firm’s monitoring and remediation processes that indicate that the firm’s policies or procedures are operating effectively or that do not provide any indications of deficiencies).

#### Designing and Implementing Responses at the Engagement Level (Ref: Para. 4(b))

- A9. Due to the specific nature and circumstances of each audit engagement and changes that may occur during the engagement, a firm cannot identify all quality risks that may arise at the engagement level or set forth all relevant and appropriate responses. Accordingly, the engagement partner exercises professional judgment in determining whether to design and implement responses, beyond those set forth in the firm’s policies or procedures, at the engagement level in order to meet the objective of this ISA.<sup>21</sup> The engagement partner’s determination of whether such engagement level responses are required (and if so,

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<sup>21</sup> ISA 200 requires the auditor to exercise professional judgment in planning and performing an audit of financial statements.



what those responses are) is influenced by the requirements of this ISA, and the engagement partner's understanding of the nature and circumstances of the engagement and any changes thereto. For example, unanticipated circumstances may arise during the course of the engagement that may cause the engagement partner to request the involvement of appropriately experienced personnel in addition to those initially assigned or made available by the firm.

A10. The relative balance of the engagement partner's efforts to comply with the requirements of this ISA (i.e., between implementing the firm's responses and designing and implementing engagement-specific responses beyond those set forth in the firm's policies or procedures) may vary. For example, the firm may design an audit program to be used in circumstances that are applicable to the audit engagement (e.g., an industry-specific audit program). Other than determining the timing and extent of procedures to be performed, there may be little or no need for supplemental audit procedures to be added to the audit program at the engagement level. Alternatively, the engagement partner's actions in complying with the engagement performance requirements of this ISA may be more focused on designing and implementing responses at the engagement level to deal with the specific nature and circumstances of the engagement (e.g., planning and performing procedures to address risks of material misstatement not contemplated by the firm's audit programs).

Providing the Firm with Information from the Audit Engagement (Ref: Para. 4(c))

A11. The firm's policies or procedures may require the engagement team to provide the firm with specific information from the audit engagement that is relevant to the design, implementation, and operation of the firm's system of quality management. During the engagement, the engagement partner may become aware (including through being informed by other members of the engagement team) that the firm's responses to quality risks are deficient in the context of the specific engagement. Providing such information to the firm may be relevant to the firm's monitoring and remediation process. For example, if an engagement team member identifies that an audit program provided by the firm does not deal with new or revised regulation, timely communication of such information to the appropriate individuals within the firm enables the firm to take steps to update and reissue the audit program to deal with such regulation.

Information Relevant to Quality Management at the Engagement Level (Ref: Para. 5)

A12. Complying with the requirements in other ISAs may provide information that is relevant to quality management at the engagement level. For example, the understanding of the entity and its environment required to be obtained under ISA 315 (Revised)<sup>22</sup> provides information that may be relevant to complying with the requirements of this ISA. Such information may be relevant to the determination of:

- The nature of resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high risk areas, or the involvement of experts to deal with complex matters;
- The amount of resources to allocate to specific audit areas, such as the number of team members assigned to attend the physical inventory count at multiple locations;
- The nature, timing and extent of review of the work performed by members of the team based on the number and significance of the assessed risks of material misstatement; or

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<sup>22</sup> ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

- The allocation of the budgeted audit hours, including allocating more time, and the time of more experienced engagement team members to those areas where there are more risks of material misstatement or the identified risks are assessed as higher.

Public Interest (Ref: Para. 6)

A13. Relevant ethical requirements contain requirements and application material for professional accountants that enable professional accountants to meet their responsibility to act in the public interest. In the context of engagement performance, the consistent performance of quality engagements forms part of the professional accountant's responsibility to act in the public interest.

Considerations Specific to Smaller Firms (Ref: Para. 2–4)

A14. In a smaller firm, the design and implementation of many responses to the firm's quality risks, may be most effectively dealt with by the engagement partner at the engagement level (i.e., given the nature and circumstances of the firm and the engagements it performs, there may be less need for firm level responses to many of the firm's quality risks). Additionally, a smaller firm's policies or procedures may be less formal. For example, in a very small firm with a relatively small number of audit engagements, the firm may determine that there is no need to establish a firm-wide system to monitor independence, and rather, independence will be monitored at the individual engagement level by the engagement partner.

A15. If an audit is carried out entirely by the engagement partner, some requirements in this ISA are not relevant because they are conditional on the involvement of other members of the engagement team. For example, the requirements relating to direction, supervision, and review of the work of other members of the engagement team are only relevant if there are members of the engagement team other than the engagement partner.

**Definitions**

*Engagement Team* (Ref: Para. 10(d))

A16. Engagement teams may be organized in a variety of ways. For example, engagement team members may be located together or across different geographic locations, and may be organized in groups by activity they are performing. Regardless of how the engagement team is organized, any individual who performs audit procedures<sup>23</sup> on the audit engagement is considered to be a member of the engagement team. External experts and internal auditors providing direct assistance are not members of the engagement team. ISA 620<sup>24</sup> and ISA 610<sup>25</sup> include requirements for the auditor to comply with when using the work of an external expert or when using the work of internal auditors in a direct assistance capacity. The auditor performs audit procedures to comply with these requirements and these procedures form the basis for the auditor's determination as to whether work performed by external experts or internal auditors providing direct assistance can be used as audit evidence.

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<sup>23</sup> ISA 500, *Audit Evidence*, paragraph A10

<sup>24</sup> See ISA 620, paragraph 12–13

<sup>25</sup> See ISA 610 (Revised 2013), paragraphs 21–25

- A17. Engagement teams may include individuals from service delivery centers who perform audit procedures. For example, the firm may determine that specific tasks that are repetitive or specialized in nature can be performed by a group of appropriately skilled personnel and the engagement team may therefore include such individuals. Service delivery centers may be established at the firm level, at the network level, or by another firm or group of firms from within the same network. For example, a centralized function may be used to facilitate external confirmation procedures.
- A18. Engagement teams may include individuals from network firms or other firms to perform audit procedures, for example, procedures such as attending a physical inventory count or inspecting physical fixed assets at a remote location.
- A19. If the audit engagement is subject to an engagement quality review, the engagement quality reviewer, and individuals who assist the engagement quality reviewer in performing the engagement quality review, are not members of the engagement team.

*Firm* (Ref: Para. 10(e))

- A20. The definition of “firm” in relevant ethical requirements may differ from the definition set out in this ISA. For example, the IESBA Code defines the “firm” as:
- (a) A sole practitioner, partnership or corporation of professional accountants;
  - (b) An entity that controls such parties through ownership, management or other means; and
  - (c) An entity controlled by such parties through ownership, management or other means.

In complying with the requirements in this ISA, the definitions used in the relevant ethical requirements apply in so far as is necessary to interpret those ethical requirements.

*“Network” and “Network Firm”* (Ref: Para. 10(f)–10(g))

- A21. The definitions of “network” or “network firm” in relevant ethical requirements may differ from those set out in this ISA. The IESBA Code also provides guidance in relation to the terms “network” and “network firm.” Networks and the firms within the network may be structured in a variety of ways, and are in all cases external to the firm. The provisions in this ISA in relation to networks apply to any structures or organizations that do not form part of the firm, but that exist within the network.

**Leadership Responsibilities for Managing and Achieving Quality on Audits** (Ref: Para. 11–13)

*Taking Overall Responsibility for Managing and Achieving Quality*

- A22. The engagement partner’s responsibility for managing and achieving quality is supported by a firm culture that promotes the conduct of quality audit engagements. In addressing the requirements in paragraphs 11 and 12, the engagement partner may communicate directly and reinforce this communication through personal conduct and actions (e.g., leading by example). A commitment to quality is further shaped and reinforced by the engagement team members as they demonstrate expected behaviors when performing the engagement.
- A23. The nature and extent of the actions of the engagement partner to reflect the firm’s commitment to quality may depend on a variety of factors including the size, structure, geographical dispersion and complexity of the firm, and the nature and circumstances of the audit engagement. With a smaller engagement team, with few engagement team members, influencing the desired culture through

direct interaction and conduct may be sufficient, whereas for a larger engagement team that is dispersed over many locations, more formal communications may be necessary.

*Sufficient and Appropriate Involvement*

A24. Being sufficiently and appropriately involved throughout the audit engagement may be demonstrated by the engagement partner in different ways, including:

- Taking responsibility for the nature, timing and extent of the direction and supervision of members of the engagement team, and the review of the work performed in complying with the requirements of this ISA;
- Varying the nature, timing and extent of such direction, supervision, and review, in the context of the nature and circumstances of the engagement.

*Communication*

A25. Communication is the means through which the engagement partner and the members of the engagement team share relevant information on a timely basis in order to comply with the requirements of this ISA, thereby contributing to the achievement of quality on the audit engagement. Communication may be between or among members of the engagement team, or with:

- (a) The firm, such as with personnel performing activities within the firm's system of quality management, including those assigned ultimate or operational responsibility for the firm's system of quality management;
- (b) Others involved in the audit (e.g., an auditor's external expert or component auditor); and
- (c) Parties that are external to the firm (e.g., management, those charged with governance, or regulatory authorities).

A26. The nature and circumstances of the audit engagement may affect the engagement partner's decisions regarding the most appropriate means of effective communication with the engagement team members. For example, in-person and more frequent interactions are likely to be a more effective way to direct and supervise less experienced team members.

*Professional Skepticism*

A27. As explained in paragraph 7, professional skepticism supports the quality of judgments made by the engagement team and, through these judgments, the overall effectiveness of the engagement team in achieving quality at the engagement level. In some circumstances the engagement partner may need to deal with impediments to the exercise of professional skepticism at the engagement level such as:

- Tight deadlines or budget constraints may negatively affect the behavior of those who perform the work as well as those who direct, supervise and review it;
- Lack of cooperation or undue pressures imposed by management may negatively affect the engagement team's ability to resolve complex or contentious issues;
- Insufficient emphasis on the importance of quality may undermine the exercise of professional skepticism by the engagement team;

- Insufficient understanding of the entity and its environment, its system of internal control, and the applicable financial reporting framework may constrain the ability of the engagement team to make appropriate judgments and an informed questioning of management's assertions;
  - Difficulties in obtaining access to records, facilities, certain employees, customers, vendors, or others may cause the engagement team to bias the selection of sources of audit evidence and seek audit evidence from sources that are more easily accessible; and
  - Overreliance on tools and templates may undermine the exercise of professional skepticism by the engagement team.
- A28. Unconscious or conscious auditor biases may affect the engagement team's professional judgments, including for example, the selection of an audit approach, performance of audit procedures, or evaluation of audit evidence. Examples of unconscious auditor biases that may affect the exercise of professional skepticism, and therefore the reasonableness of the professional judgments made by the engagement partner in complying with the requirements of this ISA, include:
- Availability bias, which involves considering information that is easily retrievable from memory as being more likely, more relevant, and more important for a judgment.
  - Confirmation bias, which involves seeking, and treating as more persuasive, information that is consistent with initial beliefs or preferences.
  - Overconfidence bias, which involves overestimating one's own abilities to perform tasks or to make accurate assessments of risk or other judgments and decisions.
  - Anchoring bias, which involves making assessments by starting from an initial numerical value and then adjusting insufficiently away from that initial value in forming a final judgment.
- A29. Possible actions that the engagement partner may take to deal with impediments to the exercise of professional skepticism at the engagement level include:
- Remaining alert to changes in the nature or circumstances of the audit engagement that necessitate additional or different resources for the engagement, and requesting additional or different resources from those individuals within the firm responsible for allocating or assigning resources to the engagement;
  - Explicitly alerting the engagement team to instances or situations when vulnerability to unconscious or conscious auditor biases may be greater (e.g., areas involving greater judgment) and emphasizing the importance of seeking advice from more experienced members of the engagement team in planning and performing audit procedures (see paragraph A28);
  - Changing the composition of the engagement team assigned, for example, involving more experienced staff in order to obtain greater skills or knowledge or specific expertise;
  - Involving more experienced members of the engagement team when dealing with members of management who are difficult or challenging to interact with;
  - Involving members of the engagement team with specialized skills and knowledge, or an auditor's expert to deal with complex or subjective areas of the audit;
  - Modifying the nature, timing and extent of direction and supervision of engagement team members, and review of their work, for complex or subjective areas of the audit, including

involving more experienced members of the team, more in-person oversight on a more frequent basis and more in-depth reviews of certain working papers;

- Setting expectations for:
  - Less experienced members of the engagement team to seek advice frequently and on a timely basis from more experienced team members or the engagement partner;
  - More experienced team members to be available to less experienced members of the engagement team throughout the audit and to respond positively and on a timely basis to their insights, requests for advice, or assistance; and
- Communicating with those charged with governance when management imposes undue pressure or the engagement team experiences difficulties in obtaining access to records, facilities, certain employees, customers, vendors, or others from whom audit evidence may be sought.

*Assigning Procedures, Tasks, or Actions to Other Members of the Engagement Team* (Ref: Para. 13)

A30. The engagement partner is ultimately responsible and therefore accountable for managing and achieving quality on the audit engagement. However, it will generally not be possible or practical for all of the requirements in this ISA to be dealt with solely by the engagement partner (e.g., due to the nature and size of the entity, or the complexity of the audit and the need for specialized skills or expertise). In managing quality at the engagement level, the engagement partner may therefore assign responsibility for procedures, tasks, or other actions to appropriately skilled or suitably experienced members of the engagement team who assist the engagement partner in complying with the requirements of this ISA. For example, engagement team members other than the engagement partner may be assigned supervisory roles.

**Relevant Ethical Requirements, Including Those Related to Independence** (Ref: Para. 14–19)

*Relevant Ethical Requirements*

A31. ISA 200<sup>26</sup> requires that the auditor comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements. Relevant ethical requirements may vary depending on the nature and circumstances of the engagement. For example, there may be requirements related to independence that are applicable only when performing audits of listed entities.

A32. Based on the nature and circumstances of the audit engagement, certain relevant ethical requirements, or aspects of law or regulation, may be of significance to the engagement, for example law or regulation dealing with money laundering, corruption, or bribery.

*Firms Policies or Procedures to Deal With Relevant Ethical Requirements*

A33. Information and communication, and resources provided by the firm may assist the engagement partner and other members of the engagement team in understanding and fulfilling relevant ethical requirements applicable to the nature and circumstances of the audit engagement in accordance with paragraphs 14–19. For example:

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<sup>26</sup> ISA 200, paragraphs 14 and A16-A19

- Communicating the independence requirements to all personnel and others subject to independence requirements, as applicable.
  - Providing training for personnel on relevant ethical requirements.
  - Establishing manuals and guides (i.e., intellectual resources), containing the provisions of the relevant ethical requirements and guidance on how they are applied in the circumstances of the firm and the engagements it performs.
  - Assigning personnel (i.e., human resources) to manage and monitor compliance with relevant ethical requirements (e.g., ISQM 1 requires that the firm obtain, at least annually, a documented confirmation of compliance with the independence requirements from all personnel required by relevant ethical requirements to be independent) or to provide consultation on matters related to relevant ethical requirements.
  - Establishing policies or procedures for personnel to communicate relevant information to appropriate parties within the firm or to the engagement partner, such as requirements for engagement teams or personnel to:
    - Communicate information about client engagements and the scope of services, including non-assurance services, to enable the firm to identify threats to independence during the period of the engagement and during the period covered by the subject matter.
    - Communicate circumstances and relationships that may create a threat to independence, so that the firm can evaluate whether such a threat is at an acceptable level and if it is not, address the threat by eliminating it or reducing it to an acceptable level.
    - Promptly communicate any breaches of the relevant ethical requirements, including those related to independence.
  - Establishing an information system, including through IT applications (i.e., technological resources), to monitor compliance with relevant ethical requirements, including recording and maintaining information about independence.
- A34. The engagement partner may take into account the information, communication and resources described in paragraph A33 when determining whether, and if so, the degree to which, the engagement partner may depend on the firm's policies or procedures in complying with relevant ethical requirements. For example, the engagement partner may be able to depend on information systems that monitor independence. See paragraphs A7–A8.
- A35. Open and robust communication between the engagement partner and the members of the engagement team about relevant ethical requirements may also assist in:
- Drawing the attention of engagement team members to relevant ethical requirements that may be of particular significance to the audit engagement; and
  - Keeping the engagement partner informed about matters relevant to the engagement team's understanding and fulfillment of relevant ethical requirements and the firm's related policies or procedures.

*Identifying and Evaluating Threats to Compliance with Relevant Ethical Requirements* (Ref: Para. 15–16)

- A36. In accordance with proposed ISQM 1, the firm's responses to address the quality risks in relation to relevant ethical requirements, including those related to independence, include policies or procedures that address the identification and evaluation of threats to compliance with the relevant ethical requirements and how identified threats should be addressed.
- A37. Relevant ethical requirements may contain provisions regarding the identification and evaluation of threats and how they should be dealt with. For example, the IESBA Code explains that a self-interest threat to compliance with the fundamental principle of professional competence and due care may arise if the fee quoted for an audit engagement is so low that it might be difficult to perform the engagement in accordance with professional standards.

*Actual or Suspected Breaches of Relevant Ethical Requirements* (Ref: Para. 17)

- A38. In accordance with proposed ISQM 1, the firm is required to establish policies or procedures that address the identification, communication, evaluation and reporting of breaches and actions to address the causes and consequences of the breaches.

*Taking Appropriate Action* (Ref: Para. 18)

- A39. Appropriate actions may include, for example:
- Following the firm's policies or procedures regarding breaches of relevant ethical requirements, including communicating to or consulting with the appropriate personnel within the firm so that appropriate action can be taken, including as applicable, disciplinary action(s);
  - Communicating with those charged with governance;
  - Communicating with regulatory authorities. In some circumstances, communication with regulatory authorities may be required by law or regulation;
  - Seeking legal advice; or
  - Withdrawing from the audit engagement, when withdrawal is possible under applicable law or regulation.

*Prior to Dating the Auditor's Report* (Ref: Para. 19)

- A40. ISA 700 (Revised) requires that the auditor's report include a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit, and that the auditor has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.<sup>27</sup> Performing the procedures required by paragraphs 14–19 of this ISA provides the basis for these statements in the auditor's report.

*Considerations Specific to Public Sector Entities*

- A41. Statutory measures may provide safeguards for the independence of public sector auditors. 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 promote compliance with the spirit of paragraph 14. This may include, where the public

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<sup>27</sup> ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, paragraph 28(c)



sector auditor's mandate does not permit withdrawal from the audit engagement, disclosure through a public report of circumstances that have arisen that would, if they were in the private sector, lead the auditor to withdraw.

**Acceptance and Continuance of Client Relationships and Audit Engagements** (Ref: Para. 20–22)

- A42. Proposed ISQM 1 requires the firm to establish quality objectives that address the acceptance and continuance of client relationships and specific engagements that are appropriate in the circumstances.
- A43. Information such as the following assists the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate:
- The integrity and ethical values of the principal owners, key management and those charged with governance of the entity;
  - Whether there are sufficient and appropriate resources to perform the engagement;
  - Whether management and those charged with governance have acknowledged their responsibilities in relation to the engagement;
  - Whether the engagement team has the competence and capabilities, including sufficient time to perform the engagement;
  - Whether significant matters that have arisen during the current or previous engagement have implications for continuing the engagement.
- A44. Under proposed ISQM 1, for acceptance and continuance decisions, the firm is required to make appropriate judgments about whether it will have access to information to perform the engagement, or to the persons who provide such information. The engagement partner may use the information considered by the firm in this regard in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate. If the engagement partner has concerns regarding the appropriateness of the conclusions reached, the engagement partner may discuss the basis for those conclusions with those involved in the acceptance and continuance process.
- A45. If the engagement partner is directly involved throughout the firm's acceptance and continuance process, the engagement partner will be aware of the information obtained, or used by the firm, in reaching the related conclusions. Such direct involvement may also provide a basis for the engagement partner being satisfied that the firm's policies or procedures have been followed and that the conclusions reached are appropriate.
- A46. Information obtained during the acceptance and continuance process may assist the engagement partner in complying with the requirements of this ISA and making informed decisions about appropriate courses of action. For example:
- Information about the size, complexity, and nature of the entity, including whether it is a group audit, the industry in which it operates, and the applicable financial reporting framework;
  - The entity's timetable for reporting, such as at interim and final stages;
  - In relation to group audits, the nature of the control relationships between the parent and its components; and

- Whether there have been changes in the entity or in the industry in which the entity operates since the previous audit engagement which may affect the nature of resources required, as well as the manner in which the work of the engagement team will be directed, supervised, and reviewed.
- A47. Information obtained during acceptance and continuance may also be relevant in complying with the requirements of other ISAs, as well as this ISA, for example with respect to:
- Establishing an understanding of the terms of the audit engagement, as required by ISA 210;<sup>3</sup>
  - Identifying and assessing risks of material misstatement, whether due to error or fraud, in accordance with ISA 315 (Revised) and ISA 240;<sup>28</sup>
  - Understanding the group, its components, and their environments, in the case of an audit of group financial statements in accordance with ISA 600, and directing, supervising and reviewing the work of component auditors;
  - Determining whether, and how, to involve an auditor's expert in accordance with ISA 620; and
  - The entity's governance structure in accordance with ISA 260<sup>29</sup> and ISA 265.<sup>30</sup>
- A48. Law, regulation, or relevant ethical requirements may require the auditor to request, prior to accepting the audit engagement, the predecessor auditor to provide known information regarding any facts or circumstances that, in the predecessor auditor's judgment, the auditor needs to be aware of before deciding whether to accept the engagement. In some circumstances, the predecessor auditor may be required, on request by the proposed successor auditor, to provide information regarding identified or suspected non-compliance with laws and regulations to the proposed successor auditor. For example, if the predecessor auditor has withdrawn from the engagement as a result of identified or suspected non-compliance with laws and regulations, the IESBA Code requires that the predecessor auditor, on request by a proposed successor auditor, provide all such facts and other information concerning such non-compliance that, in the predecessor auditor's opinion, the proposed successor auditor needs to be aware of before deciding whether to accept the audit appointment.
- A49. In circumstances when the firm is obligated by law or regulation to accept or continue an audit engagement, the engagement partner may take into account information obtained by the firm about the nature and circumstances of the engagement in complying with the requirement in paragraph 21.
- A50. In deciding on the necessary action in accordance with paragraph 22, the engagement partner and the firm may conclude that it is appropriate to continue with the audit engagement, and if so, what additional steps are necessary at the engagement level (e.g., the assignment of more staff, or staff with particular expertise). If the engagement partner has further concerns and is not satisfied that the matter has been appropriately dealt with, the firm's policies or procedures for resolving differences of opinion may be applicable.

*Considerations Specific to Public Sector Entities* (Ref: Para. 20–22)

- A51. In the public sector, auditors may be appointed in accordance with statutory procedures and the public sector auditor may not need to establish all policies or procedures regarding the acceptance

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<sup>28</sup> ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

<sup>29</sup> ISA 260 (Revised), *Communication with Those Charged with Governance*

<sup>30</sup> ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*

and continuance of audit engagements. Nevertheless the requirements and considerations for the acceptance and continuance of client relationships and engagements as set out in paragraphs 20–22 and A42–A47 may be valuable to public sector auditors in performing risk assessments and in carrying out reporting responsibilities.

**Engagement Resources** (Ref: Para. 23–26)

A52. Under proposed ISQM 1, the resources assigned, allocated, or made available by the firm to support the performance of audit engagements include:

- Human resources;
- Technological resources; and
- Intellectual resources.

Under proposed ISQM 1, the firm's quality objectives are required to address appropriately obtaining, developing, using, maintaining, allocating and assigning such resources in a timely manner to enable the design, implementation and operation of the system of quality management. Based on the nature and circumstances of the engagement the engagement partner may be able to depend on the firm's policies or procedures that address the quality risks related to such quality objectives when complying with the requirements in paragraphs 23–26 of this ISA (see also paragraphs A7–A8).

A53. A relevant consideration for the engagement partner, in complying with the requirements in paragraph 23 and 24, is whether the resources assigned or made available to the engagement team enable fulfillment of relevant ethical requirements, including ethical principles, such as professional competence and due care.

*Human Resources*

A54. Human resources assigned or made available by the firm include members of the engagement team and, where applicable, external experts. In addition, as provided for by ISA 610 (Revised 2013) individuals from within the entity's internal audit function may provide direct assistance.

A55. An engagement team includes any individuals with expertise in a specialized area of accounting or auditing who perform audit procedures on the audit engagement, for example, individuals with expertise in accounting for income taxes, information technology, or in using automated tools to analyze complex data or to perform statistical analysis.

*Technological Resources*

A56. The use of technological resources on the audit engagement may assist the auditor in obtaining sufficient appropriate audit evidence. Technology may allow the auditor to more effectively and efficiently manage the audit. Technology may also allow the auditor to evaluate large amounts of data more easily in order to, for example, provide deeper insights, identify unusual trends, or more effectively challenge management's assertions, which enhances the ability of the auditor to exercise professional skepticism. Inappropriate use of such technological resources may however increase the risk of overreliance on the information produced for decision purposes, or may create threats to

complying with relevant ethical requirements, for example, those requirements related to confidentiality.

- A57. The firm's policies or procedures may set forth required considerations or responsibilities for the engagement team when using firm approved technology to perform audit procedures and may require the involvement of individuals with specialized skills or expertise in evaluating or analyzing the output.
- A58. The firm's policies or procedures may specifically prohibit the use of certain technological resources (e.g., software that has not yet been specifically approved for use by the firm) or may include requirements to seek approval to use a new technological resource. In some circumstances the firm's policies or procedures may not specifically deal with the use of a specific technological resource (e.g., a spreadsheet developed by the engagement team or obtained from outside the engagement team or the firm). In these circumstances, the engagement partner may apply professional judgment in considering whether the use of the resource on the audit engagement is appropriate in the context of the engagement, and if so, how the technological resource is to be used.

#### *Intellectual Resources*

- A59. Intellectual resources include, for example, firm, network firm, or network audit methodologies, implementation tools, auditing guides, model programs, templates, checklists, or forms.
- A60. The use of intellectual resources on the audit engagement may facilitate the consistent application and understanding of professional standards, laws and regulations, and related firm policies or procedures. For this purpose, the engagement team may be required, in accordance with the firm's policies or procedures, to use the firm's audit methodology and specific tools and guidance. The engagement team may also consider whether the use of other intellectual resources is appropriate and relevant based on the nature and circumstances of the engagement, for example, industry-specific methodology or related guides and performance aids.

#### *Sufficient and Appropriate Resources to Perform the Engagement (Ref: Para. 23)*

- A61. In determining whether sufficient and appropriate resources to perform the engagement have been assigned or made available to the engagement team by the firm, the engagement partner may be able to depend on the firm's related policies or procedures as described in paragraph A7. Matters that the engagement partner may take into account when making such a determination are described in paragraph A8. For example, the engagement partner may be able to depend on the firm's technological development and maintenance programs when using firm approved technology to perform audit procedures based on information communicated by the firm.

#### *Competence and Capabilities of the Engagement Team (Ref: Para. 24)*

- A62. When determining that the engagement team has the appropriate competence and capabilities, the engagement partner may take into consideration such matters as the team's:
- Understanding of, and practical experience with, audit engagements of a similar nature and complexity through appropriate training and participation.
  - Understanding of professional standards and applicable legal and regulatory requirements.
  - Expertise in specialized areas of accounting or auditing.

- Expertise in information technology used by the entity or automated tools or techniques that are to be used by the engagement team in planning and performing the audit engagement.
- Knowledge of relevant industries in which the entity being audited operates.
- Ability to exercise professional skepticism and apply professional judgment.
- Understanding of the firm's policies or procedures.

#### Project Management

A63. In situations where there are many engagement team members, for example on larger, or more complex, audit engagements, the engagement partner may involve an individual who has specialized skills or knowledge in project management, supported by appropriate technological and intellectual resources of the firm. Conversely, for a smaller engagement team with fewer engagement team members, project management may be achieved through less formal means.

A64. Project management techniques and tools may support the engagement partner and the other members of the engagement team in managing the quality of the audit engagement by, for example:

- Increasing the engagement team's ability to exercise professional skepticism through alleviating budget or time constraints that may otherwise impede the exercise of professional skepticism;
- Facilitating timely performance of audit work to more effectively manage time constraints at the end of the audit process when more difficult or contentious matters may arise;
- Monitoring the progress of the audit against the audit plan,<sup>31</sup> including the achievement of key milestones, which may assist the engagement team in being proactive in identifying the need for making timely adjustments to the audit plan and the assigned resources;
- Assisting the engagement partner in taking responsibility for the direction and supervision of engagement team members and the review of their work (see paragraph 27); or
- Coordinating arrangements with component auditors and auditor's experts.

#### *Insufficient or Inappropriate Resources (Ref: Para. 25)*

A65. Proposed ISQM 1 requires that the firm's quality objectives include that the firm's strategic decisions and actions, including financial and operational priorities, reflect the firm's commitment to quality and do not undermine the firm's role in serving the public interest by consistently performing quality engagements. However, in certain circumstances the firm's financial and operational priorities may place constraints on the resources assigned or made available to the engagement team.<sup>32</sup> In such circumstances, these constraints do not override the engagement partner's responsibility for achieving quality at the engagement level, including for becoming satisfied that the resources assigned or made available by the firm are sufficient and appropriate to perform the audit engagement.

A66. The engagement partner's determination of whether additional engagement level resources are required is a matter of professional judgment and is influenced by the requirements of this ISA and

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<sup>31</sup> ISA 300, paragraph 9

<sup>32</sup> See also paragraph A37.

the nature and circumstances of the audit engagement. If the engagement partner determines that the resources assigned or made available by the firm are insufficient or inappropriate in the circumstances of the engagement and additional or alternative resources have not been made available, the engagement partner is required to take appropriate action. In such cases, appropriate actions may include:

- If possible, discussing an extension to the reporting deadlines with management or those charged with governance.
- Following the firm's policies or procedures for resolving differences of opinion if the engagement partner does not obtain the necessary resources for the audit engagement.
- Following the firm's policies or procedures for withdrawing from the audit engagement, when withdrawal is possible under applicable law or regulation.

*Considerations Specific to Public Sector Entities (Ref: Para. 23–26)*

A67. In the public sector, specialized skills may be necessary to discharge the terms of the audit mandate in a particular jurisdiction. Such skills may include an understanding of the applicable reporting arrangements, including reporting to the legislature or other governing body or in the public interest. The wider scope of a public sector audit may include, for example, some aspects of performance auditing.

**Engagement Performance**

*Direction, Supervision and Review (Ref: Para. 27)*

- A68. Under proposed ISQM 1, the firm is required to establish policies or procedures addressing the nature, timing and extent of the direction and supervision of engagement teams and review of their work, including that such direction, supervision and review is planned and performed on the basis that the work performed by less experienced members of the engagement team is directed, supervised and reviewed by more experienced engagement team members.
- A69. Direction and supervision of the engagement team and the review of the work of the engagement team are firm level responses that are implemented at the engagement level of which the nature, timing and extent may be further tailored by the engagement partner in managing quality of the audit engagement. Accordingly, the approach to direction, supervision and review will take into account the nature and circumstances of the engagement and will generally include a combination of addressing the firm's policies or procedures and engagement-specific responses. The approach will vary from one engagement to the next.
- A70. The approach to the direction and supervision of the members of the engagement team and the review of the work performed provides support for the engagement partner in addressing the requirements in this ISA, as well as the conclusion that the engagement partner has been sufficiently and appropriately involved throughout the audit engagement in accordance with paragraph 37.
- A71. Ongoing discussion and communication among members of the engagement team allows less experienced team members to raise questions with more experienced team members (including the engagement partner) on a timely basis and enables effective direction, supervision and review in accordance with paragraph 27(c).

## Direction

A72. Direction of the engagement team may involve informing the members of the engagement team of matters such as:

- The responsibility for all engagement team members for contributing to the management and achievement of quality at the engagement level through their personal conduct, communication, and actions.
- The importance of maintaining a questioning mind and being aware of unconscious or conscious auditor biases in exercising professional skepticism in gathering and evaluating audit evidence (see paragraph A29).
- Their responsibilities to fulfill relevant ethical requirements.
- Responsibilities of respective partners where more than one partner is involved in the conduct of an audit engagement.
- Respective roles and responsibilities of the engagement team members in performing audit procedures and the roles of more experienced team members in directing, supervising and reviewing the work of less experienced team members.
- The objectives of the work to be performed and detailed instructions regarding the nature, timing and extent of planned audit procedures as set forth in the overall audit strategy and audit plan.
- Threats to the achievement of quality, and the engagement team's expected response in this regard. For example, budget constraints or resource constraints should not result in the engagement team members modifying planned audit procedures or failing to perform planned audit procedures.

## Supervision

A73. Supervision includes matters such as:

- Tracking the progress of the audit engagement, which includes:
  - Monitoring the progress against the audit plan;
  - Monitoring whether the objective of work performed has been achieved;
  - Monitoring the ongoing adequacy of assigned resources.
- Taking appropriate action to address issues arising during the engagement, including for example, reassigning planned audit procedures to more experienced members of the engagement team when issues are more complex than initially anticipated.
- Addressing matters arising during the audit engagement, considering their significance and modifying the planned approach appropriately.
- Identifying matters for consultation or consideration by more experienced engagement team members during the audit engagement.
- Providing coaching and on-the-job training to help engagement team members develop skills or competencies.

- Creating an environment where engagement team members raise concerns without fear of reprisals.

#### Review

- A74. Review of work performed provides support for the conclusion that the requirements of this ISA have been addressed.
- A75. Review of work performed consists of consideration of whether, for example:
- The work has been performed in accordance with the firm's policies or procedures, professional standards and applicable legal and regulatory requirements;
  - Significant matters have been raised for further consideration;
  - Appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
  - There is a need to revise the nature, timing and extent of work performed;
  - The work performed supports the conclusions reached and is appropriately documented;
  - The evidence obtained is sufficient and appropriate to support the auditor's report; and
  - The objectives of the audit procedures have been achieved.
- A76. The firm's policies or procedures may contain specific requirements regarding:
- The nature, timing and extent of review of audit documentation;
  - Different types of review that may be appropriate in different situations (e.g., detailed review of each individual working paper or a high-level review of selected working papers); and
  - Which members of the engagement team are required to perform the different types of review.

#### The Engagement Partner's Review of Work Performed (Ref: Para. 28–31)

- A77. The firm's policies or procedures may specify the nature, timing and extent of the engagement partner's review. As required by ISA 230, the partner documents the extent and timing of the review.<sup>33</sup>
- A78. Timely review by the engagement partner at appropriate stages during the audit engagement enables significant matters to be resolved to the engagement partner's satisfaction on or before the date of the auditor's report. The engagement partner need not review all audit documentation but may do so.
- A79. The engagement partner exercises professional judgment in identifying the areas of significant judgment made by the engagement team. Significant judgments in relation to the audit engagement may include matters related to the overall audit strategy and audit plan for undertaking the engagement, the execution of the engagement and the overall conclusions reached by the engagement team, for example:
- Matters related to planning the engagement such as matters related to determining materiality;
  - The composition of the engagement team, including:

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<sup>33</sup> ISA 230, paragraph 9(c)



- Personnel using expertise in a specialized area of accounting or auditing;
  - The use of personnel from service delivery centers;
  - The decision to involve an auditor's expert, including the decision to involve an external expert;
  - The engagement team's consideration of risks identified through the acceptance and continuance process and proposed responses to those risks;
  - The engagement team's risk assessment process, including situations where consideration of inherent risk factors and the assessment of inherent risk requires significant judgment by the engagement team;
  - The engagement team's consideration of related party relationships and transactions and disclosures;
  - Results of the procedures performed by the engagement team on significant areas of the engagement, for example, conclusions in respect of certain estimates, accounting policies, or going concern considerations;
  - The engagement team's evaluation of the work performed by experts and conclusions drawn therefrom;
  - In group audit situations:
    - The proposed overall group audit strategy and group audit plan, including the identification of significant components;
    - Decisions about the involvement of component auditors, including how to direct and supervise their work. For example, if a component auditor is located in a jurisdiction or a firm with significant audit inspection findings, then judgments about their involvement in the engagement and the direction, supervision and review of their work are likely to be more significant; and
    - The evaluation of work performed by component auditors and the conclusions drawn therefrom.
  - How matters affecting the overall audit strategy and audit plan have been addressed;
  - The significance and disposition of corrected and uncorrected misstatements identified during the engagement; or
  - The engagement team's proposed audit opinion and matters to be communicated in the auditor's report, for example, key audit matters, or a "Material Uncertainty Related to Going Concern" paragraph.
- A80. The engagement partner uses professional judgment in determining other matters to review, for example based on:
- The nature and circumstances of the audit engagement.
  - Which engagement team member performed the work.
  - Matters relating to recent inspection findings.
  - The requirements of the firm's policies or procedures.

*Nature, Timing and Extent* (Ref: Para. 27)

- A81. In accordance with paragraph 27(a), the nature, timing and extent of the direction, supervision, and review are required to be planned and performed in accordance with the firm's policies or procedures. For example, the firm may require that work planned to be performed at an interim date be directed, supervised, and reviewed at the same time as the performance of the procedures rather than at the end of the period so that any necessary corrective action can be taken on a timely basis.
- A82. In accordance with paragraph 27, the engagement partner is responsible for the nature, timing and extent of direction and supervision of the engagement team and the review of the work performed. The engagement partner may tailor the approach to direction, supervision and review depending on, for example:
- The engagement team member's previous experience with the entity and the area to be audited. For example, if the work related to the entity's information system is being performed by the same engagement team member who performed the work in the prior period and there are no significant changes to the information system, the extent and frequency of the direction and supervision of the engagement team member may be less and the review of the related working papers may be less detailed.
  - The complexity of the entity, including whether there are significant events that have occurred at the entity or in the industry in which the entity operates since the previous audit engagement or during the current engagement.
  - The assessed risks of material misstatement. For example, a higher assessed risk of material misstatement may require a corresponding increase in the extent and frequency of direction and supervision of engagement team members, and a more detailed review of their work.
  - The competence and capabilities of the individual engagement team members performing the audit work. For example, less experienced team members may require more detailed instructions and more frequent, or in person, interactions as the work is performed.
  - The manner in which the engagement partner and manager reviews of work performed are expected to take place. For example, in some circumstances remote reviews may not be effective in providing the necessary direction and may need to be supplemented by in-person interactions.
  - The structure of the engagement team, and location of engagement team members, including where service delivery centers are used. For example, direction and supervision of individuals located at remote service delivery centers and the review of their work may need to be more formalized and structured than when members of the engagement team are all situated in the same location.
- A83. In accordance with paragraph 27(b), the engagement partner is required to determine that the approach to direction, supervision and review is responsive to the nature and circumstances of the audit engagement. For example, if a more experienced member of the engagement team becomes unavailable to participate in the supervision and review of the engagement team, the engagement partner may need to increase the extent of supervision and review of the less experienced engagement team members.

*Consultation (Ref: Para. 32)*

A84. Proposed ISQM 1 requires the firm to establish policies or procedures addressing consultation on difficult or contentious matters, including the engagement team's responsibilities for consultation, the matters on which to consult, and how the conclusions should be agreed and implemented. Consultation may be appropriate or required, for example for:

- Issues that are complex or unfamiliar (e.g., issues related to an accounting estimate with a high degree of estimation uncertainty);
- Significant risks;
- Significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual;
- Limitations imposed by management; and
- Non-compliance with law or regulation.

A85. Effective consultation on significant technical, ethical and other matters within the firm or, where applicable, outside the firm can be achieved when those consulted:

- Are given all the relevant facts that will enable them to provide informed advice; and
- Have appropriate knowledge, seniority and experience.

A86. It may be appropriate for the engagement team, in the context of the firm's policies or procedures, to consult outside the firm, for example, where the firm lacks appropriate internal resources. The engagement team may take advantage of advisory services provided by other firms, professional and regulatory bodies, or commercial organizations that provide relevant quality control services.

A87. The need for consultation outside the engagement team on a difficult or contentious matter may be an indicator that the matter is a key audit matter.<sup>34</sup>

*Engagement Quality Review (Ref: Para. 33)*

A88. Proposed ISQM 1 requires that the firm establish policies or procedures that require an engagement quality review for certain types of engagements.<sup>35</sup> Proposed ISQM 2<sup>36</sup> deals with the appointment and eligibility of the engagement quality reviewer and the engagement quality reviewer's responsibilities relating to performing and documenting an engagement quality review. National requirements that deal with the appointment and eligibility of an engagement quality reviewer and the responsibilities of the engagement quality reviewer are at least as demanding as proposed ISQM 2 when they address all of the requirements in proposed ISQM 2.

*Completion of the Engagement Quality Review before Dating of the Auditor's Report (Ref: Para. 33(d))*

A89. ISA 700 (Revised) requires the auditor's report to be dated no earlier than the date on which the auditor has obtained sufficient appropriate evidence on which to base the auditor's opinion on the financial

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<sup>34</sup> ISA 701, paragraphs 9 and A15

<sup>35</sup> Proposed ISQM 1, paragraph 40(e)

<sup>36</sup> Proposed ISQM 2, *Engagement Quality Reviews*

statements.<sup>37</sup> If applicable to the audit engagement, proposed ISQM 2 requires that the engagement quality review be completed on or before the date of the auditor's report.

- A90. The auditor's report cannot be dated until the completion of the engagement quality review. For example, if the engagement quality reviewer has communicated to the engagement partner concerns about the significant judgments made by the engagement team or that the conclusions reached thereon were not appropriate then the engagement quality review is not complete.<sup>38</sup>
- A91. An engagement quality review that is conducted in a timely manner at appropriate stages during the audit engagement may assist the engagement team in promptly resolving matters raised to the engagement quality reviewer's satisfaction on or before the date of the auditor's report.
- A92. Frequent communications between the engagement team and the engagement quality reviewer throughout the audit engagement may assist in facilitating an effective and timely engagement quality review. In addition to discussing significant matters with the engagement quality reviewer, the engagement partner may assign responsibility for coordinating requests from the engagement quality reviewer to another member of the engagement team.

#### **Differences of Opinion** (Ref: Para. 34)

- A93. Proposed ISQM 1 sets out requirements for the firm to establish policies or procedures to address differences of opinion that arise within the engagement team, or between the engagement team and the engagement quality reviewer or personnel performing activities within the firm's system of quality management, including those who provide consultation.
- A94. In some circumstances, the engagement partner may not be satisfied with the resolution of the difference of opinion. In such circumstances, appropriate actions for the engagement partner may include, for example:
- Seeking legal advice; or
  - Withdrawing from the audit engagement, when withdrawal is possible under applicable law or regulation.

#### **Monitoring and Remediation** (Ref: Para. 36)

- A95. Under proposed ISQM 1, the firm is required to establish quality objectives and responses that address the firm's monitoring and remediation process that enable the evaluation of the design, implementation and operation of the components of the system of quality management and whether the quality objectives have been achieved. In addition, the firm is required to communicate to personnel information about the firm's monitoring and remediation process to the extent that it is relevant to their responsibilities and to enable the personnel to take prompt and appropriate action in accordance with their responsibilities. The results of the firm's monitoring and remediation activities are based on an evaluation of findings from the firm's monitoring activities, the results of external inspections and other relevant information that the firm obtains or of which the firm becomes aware.
- A96. Information provided by the firm may be relevant to the audit engagement when, for example, it deals with findings identified on another engagement done by the engagement partner or engagement team, findings from the local firm office or previous inspection results of this particular engagement.

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<sup>37</sup> ISA 700 (Revised), paragraph 49

<sup>38</sup> Proposed ISQM 2, paragraph 21(b)

A97. In considering relevant information communicated by the firm and how it may affect the audit engagement, the engagement partner may consider the remedial actions designed and implemented by the firm to deal with identified deficiencies and, to the extent relevant to the nature and circumstances of the engagement, communicate accordingly to the engagement team. The engagement partner may also determine whether additional remedial actions are needed at the engagement level. For example, the engagement partner may determine that:

- An auditor's expert should be used;
- The nature, timing and extent of direction, supervision, and review needs to be enhanced in an area of the audit where deficiencies have been identified.

If an identified deficiency does not affect the quality of the audit (e.g., if it relates to a technological resource that the engagement team did not use) then no further action may be needed.

A98. A deficiency in the firm's system of quality management does not necessarily indicate that a particular audit engagement was not performed in accordance with professional standards and applicable legal and regulatory requirements, or that the auditor's report was not appropriate.

#### **Taking Overall Responsibility for Managing and Achieving Quality** (Ref: Para. 37)

A99. Under proposed ISQM 1, the firm is required to establish objectives relating to the engagement partner's overall responsibility for managing and achieving quality on the engagement and for being sufficiently and appropriately involved throughout the engagement.

A100. Relevant considerations in addressing the requirement in paragraph 37 include determining how the engagement partner has complied with the requirements of this ISA, given the nature and circumstances of the audit engagement, and how the audit documentation evidences the engagement partner's involvement in the engagement.

A101. If the engagement's partner's involvement does not provide the basis for determining that the significant judgments made and the conclusions reached are appropriate, the engagement partner will not be able to reach the determination required by paragraph 37. In addition to taking account of firm policies or procedures that may set forth the required actions to be taken in such circumstances, appropriate actions that the engagement partner may take, include, for example:

- Reevaluating the planned approach to the nature and extent of review and modifying the planned approach to increase the involvement of the engagement partner; or
- Consulting with firm personnel assigned operational responsibility for the relevant aspect of the firm's system of quality management.

#### **Documentation** (Ref: Para. 38)

A102. In accordance with ISA 230,<sup>39</sup> audit documentation provides evidence that the audit complies with the ISAs. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit. Further, it is unnecessary for the auditor to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the audit file. Documentation of the performance of the

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<sup>39</sup> ISA 230, paragraph A7

requirements of this ISA, including evidencing the involvement of the engagement partner, may be accomplished in different ways. For example:

- Direction of the engagement team can be documented through signoffs of the audit plan and project management activities;
- Minutes from meetings of the engagement team may provide evidence of the clarity, consistency, and effectiveness of the engagement partner's communications and other actions in respect of culture and expected behaviors that reflect the firm's commitment to quality;
- Agendas from discussions between the engagement partner and engagement team members, and where applicable the engagement quality reviewer, and related time records, may provide evidence of the engagement partner's involvement throughout the audit; and
- Signoffs by the engagement partner and other members of the engagement team provide evidence that the working papers were reviewed.

A103. When dealing with circumstances that may pose risks to achieving quality on the audit engagement, the exercise of professional skepticism, and the documentation of the auditor's consideration thereof, may be important. For example, if the engagement partner obtains information that may have caused the firm to decline the engagement (see paragraph 22), the documentation may include explanations of how the engagement team dealt with the circumstance.

A104. Documentation of consultations with other professionals that involve difficult or contentious matters that is sufficiently complete and detailed contributes to an understanding of:

- The nature and scope of the issue on which consultation was sought; and
- The results of the consultation, including any decisions taken, the basis for those decisions and how they were implemented.

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# Attachment to AUASB Board Meeting Summary Paper

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<b>AGENDA ITEM NO.</b>	<b>3.4</b>
<b>Meeting Date:</b>	12 June 2019
<b>Subject:</b>	Quality Management Standards – Summary of Stakeholder Feedback
<b>Date Prepared:</b>	4 June 2019

## Objective of Attachment to Board Meeting Summary Paper

To inform the AUASB of the main themes / messages expressed by stakeholders at the Melbourne, Sydney and Brisbane roundtables.

## Summary of main themes/messages

### 1. ISQM 1

- (a) Scalability and Prescriptiveness
  - (i) On balance, stakeholders considered that it is difficult to argue that the concepts of a Quality Management (QM) System are not scalable. Stakeholders expressed concern around the workability and practical implementation of the standard rather than scalability. Scalability is sometimes viewed as doing less, while it is actually about doing what's right dependent upon the nature and circumstances of the firm.
  - (ii) Stakeholders commented that the sheer volume of requirements makes the standard prescriptive. There were mixed views expressed as to the value of having baseline granularity included as requirements in the standard, particularly for SMPs where a baseline level of requirements is sometimes considered helpful. Other stakeholders commented that to retain a strictly principles based standard, the baseline requirements, particularly around objectives and design and implementation could be included as guidance outside of the requirements of the standard.
  - (iii) Stakeholders expressed concern that the standard contained requirements around design and implementation while no requirements were established over the underlying risks. Accordingly stakeholders considered this to be counter intuitive to the very nature of a risk based standard. Based on the current design of the standard, there is concern by practitioners that firms will

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backfill their risks and objectives based on the design and implementation requirements of the standard.

- (iv) Further to the level of granularity comments made above, some stakeholders expressed concern that the application of ISQM 1 would lead to a boiler-plate compliance exercise. There are 8 components, if each component has multiple quality objectives and each quality objective has multiple risks associated and for each risk there needs to be a response, this could eventuate in an impractical position.
  - (v) Stakeholders commented that ISQM 1 contains principles already included in *APES 325 Risk Management for Firms* that sets out mandatory requirements and guidance for members in public practice to establish and maintain a risk management framework in their firms in respect of the provision of quality and ethical professional services. Accordingly, from an Australian perspective, the impact of ISQM 1 may not be too onerous.
  - (vi) Some stakeholders commented that if the IAASB needs to issues FAQs and examples at the time of Exposure – this may well indicate that the document in its current form is unworkable.
- (b) Implementation Considerations:
- (i) The sheer volume of the standard will practically mean much needed resources at a significant cost to practitioners, particularly at the SMP level.
  - (ii) The enhanced requirements around network firms, while supported by stakeholders, is seen to be a practical challenge that will need to be worked through by network firms. Some stakeholders expressed concern that the granularity of the requirements may undermine the purpose of being in a network and lead to unintended consequences. Additionally, there was a level of concern raised by stakeholders as to the consistency of application across network firms in different jurisdictions and what this means from a regulatory perspective.
  - (iii) Owing to the volume of the requirements in the proposed standard, stakeholders considered that a longer application period would be required, perhaps even a staged implementation process.
- (c) Structure of the standard
- (i) Stakeholders were supportive of the structure of the standard into the 8 components of a Quality Management System and supported the risk assessment process embedded in the standard. Stakeholders supported the flexibility that the standard allows in terms of the 8 components.

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- (d) Risk Assessment Process
  - (i) Stakeholders supported the RAP as outlined in the requirements of the standard.
  - (ii) Stakeholders expressed concern around the requirement to establish additional quality objective and D&I beyond those required by the standard and how this could be demonstrated and regulated. Stakeholders were unsure as to whether there would always be additional quality objectives and D&I beyond those required by the standard, particularly for SMPs as the standard is considered to be comprehensive. Stakeholders will be seeking clarification on this point.
- (e) Introductory Paragraphs and Appendix
  - (i) Stakeholders considered the introductory paragraphs and Appendix to be useful and educative, but largely repetitive of concepts included in the requirements of the standard. Stakeholders supported retaining the concepts included in the introductory paragraphs and Appendix, but there were mixed views as to whether the content should remain within the body of the standard or could be included in an explanatory document outside of the standard.
  - (ii) There was a discussion around the existing form and content of the Basis of Conclusions and discussion around whether this should actually be an expanded document taking users through the considerations from extant to new standard, rather than from ED to new standard. The document could then include educative material for example the introductory paragraphs and the appendix.
- (f) Technology
  - (i) Stakeholders were supportive of the recognition of the use of technology in this standard. Stakeholders considered that the balance of requirements is appropriate and that the standard is sufficiency principles based in this area.
  - (ii) Some stakeholders considered that the standard should explicitly recognise that manual systems may still be appropriate in limited circumstances, particularly in the SMP environment.
  - (iii) One stakeholder raised a concern that that new standard prescribes additional work on all IT applications (for example audit software) that will be onerous, expensive and time consuming.
- (g) Documentation
  - (i) Based on the sheer volume of requirements in the standard as well as the additional requirements to go beyond the standard in terms of objectives and

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design and implementation, stakeholders expressed concern at a regulatory ‘if not why not’ expectation.

- (ii) Stakeholders considered that the extent of documentation could get overly burdensome considering that there are 8 components, with each component having multiple quality objectives and each quality objective having multiple risks associated and for each risk there needs to be a response, this could eventuate in an impractical position to document.
- (h) Monitoring and Remediation
- (i) Stakeholders expressed concern that the current definition of deficiency would capture everything in the standard and therefore were unsure as to how all findings didn’t result in a deficiency. Stakeholders commented that the application material provided guidance in this area, but that the requirements of the standard should be able to stand-alone.
- (i) Networks and Service Providers
- (i) Stakeholders generally supported the requirements around networks and service providers. The more granular requirements were seen to be important in improving audit quality, however practically stakeholders could see implementation challenges in these areas.
  - (ii) Stakeholders commented that the purpose of being part of a network is leverage and the benefits of systems, stakeholders expressed concern that if such reliance was diminished, there may be unintended negative impacts on audit quality.
  - (iii) Stakeholders commented that different regulator expectations and interpretation of the standard in the area of networks and service providers could be problematic across jurisdictions.
  - (iv) Stakeholders expressed concern around the concept of service providers particularly the examples given in paragraph A205 and were uncertain as to who would be captured. Stakeholders found the concept of service providers confusing when considering the service organisations in ISA 402 and sought clarity in this regard.

## 2. ISQM 2

- (a) Stakeholders were largely supportive of ISQM 2 however raised significant concerns over the new term of significant public interest as introduced by ISQM 1.
- (b) Stakeholders were unsure as to why this new term was being introduced and considered that if an entity is a public interest entity, then it must be significant. Additionally, stakeholders commented that this term would not be able to be defined

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consistently across jurisdictions and therefore ISQM 2 would not be applied consistently.

**3. ISA 220**

- (a) Stakeholders were largely supportive of ISA 220, however raised concern regarding the definition of engagement team – with particular reference to the lack of a definition of ‘audit procedures’; stakeholders considered that the definition could be centred around a clarification of of procedures to be captured rather than the role of the person.
- (b) Stakeholders considered that the documentation requirements of ISA 220, did not link directly to the extensive requirements of the standard, and accordingly raised regulatory concerns. Stakeholders considered that the documentation requirements could be more granular or alternatively additional guidance was needed in this area.
- (c) Stakeholders commented that the expectations of the engagement partner in relation to ISQM 1 were not clear and that additional guidance is needed in this area.

***Part B – NZAuASB***

- 1. The ATG has reviewed the draft NZAuASB submission to the IAASB and the themes are consistent with the ATG summary provided above.

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# AUASB Board Meeting Summary Paper

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**AGENDA ITEM NO.**        **4**

**Meeting Date:**            13 June 2019

**Subject:**                    GS 005 Using the Work of a Management's Expert

**Date Prepared:**            4 June 2019

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**Action Required**

**For Information Purposes Only**

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## **Agenda Item Objectives:**

To inform the AUASB on the progress to the revision of GS 005 *Using the Work of a Management's Expert*.

## **Background**

1. The audit technical group (ATG) met with the big 6 audit firms to identify areas of the auditing standards that may require clarification or guidance, as identified through internal quality review findings or, external inspection findings. The ATG summarised the findings and came up with a summary of matters that had been raised consistently across the firms – these findings were shared with ASIC and the AUASB.
2. The ATG and the AUASB Chair met with ASIC to discuss the findings as well as discussing a possible way forward on some of these matters.
3. The ATG presented the AUASB with a paper at the September 2018 AUASB meeting that summarised the areas that the ATG had identified as potentially being appropriate for supporting some form of guidance from the AUASB.
4. At the 4/5 December 2018 AUASB meeting, the AUASB approved the Project Plan to revise GS 005.

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### **Purpose of Revision:**

5. Using the work of a management's expert has expanded in practice. This has been largely led by changes in financial reporting frameworks and changes in current thinking in this area across jurisdictions. Examples of such changes include the release of the new standard on auditing accounting estimates (ASA 540) and the PCAOB amendments to its standards (AS 1105 *Audit Evidence* Appendix A) for using the work of specialists. Additionally, in recent times, this area has been the subject of internal and external audit file reviews. As a result of these changes the AUASB has become aware that the current GS 005 does not reflect current practice in this area, so in order to enhance audit quality in the area of management's experts and provide additional guidance to practitioners so that there can be consistently rigorous practices among audit firms of all sizes, the AUASB agreed to revise GS 005.

### **Principles underpinning the revision:**

6. The revision needs to improve audit quality in the area of using the work of a management's expert by increasing auditor's focus when using that work, particularly when that work is significant in areas of higher risk. By enhancing the guidance for evaluating the work of a management's expert, reflecting the requirements of ASA 500, ASA 620, ASA 540 and other leading national jurisdictions guidance/standards, the expected audit effort in this area is expected to be made clearer, thereby resulting in a consistent and appropriate approach to auditing this area, thus enhancing audit and assurance quality.
7. The public interest needs of consistent and appropriate application of auditing and assurance standards and guidance needs to be achieved. Accordingly the revision needs to provide guidance around the requirements already contained within ASA 500, ASA 540 (revised) and ASA 620.
8. To achieve international consistency of interpretation, the revision of the guidance will need to consider interpretation of recently updated guidance / standard of using the work of a management's expert in other leading national jurisdictions.
9. The revision needs to provide sufficient and appropriate guidance so that interpretation of the expectations of auditors in this area is consistent across user groups including practitioners and regulators.

### **Consultation / research that has occurred on revision to GS 005**

10. The AUASB approved the setting up, of a Project Advisory Group (December 2018) to advise the writing of this guidance, and given the need to reflect best current practice it was decided to involve practitioners. Each practitioner (including Public Sector) on the AUASB nominated an appropriate person from their respective firms to provide input into the revision of GS 005, all feedback from 6 practitioner firms as well as the QAO have been incorporated into the draft Guidance Statement. Two teleconferences have been held on this subject matter to progress the revision to the guidance statement.
11. Reference to the requirements and guidance of ASA 500 Audit Evidence, ASA 540 Auditing Accounting Estimates and Related Disclosures and ASA 620 Using the Work of an Auditor's Expert.
12. Review of CPA Canada Implementation tool for auditors Using the Work of a Management's Expert (April 2017) – which is evaluated as fairly aligned to the extant GS 005.
13. Review of PCAOB Release No 2018-006 Amendments to Auditing Standards for Auditor's Use of the Work of Specialists, where the PCAOB sought to enhance the testing and evaluation of the work

of a company's specialist designed to increase audit attention in areas where a specialist is used and to align the applicable requirements with the PCAOB's risk assessment standards.

14. Review of South African Institute of Chartered Accountants Frequently Asked Questions (October 2018): When information to be used as audit evidence involves the work of experts. The purpose of the FAQ was to address uncertainty about the meaning of a management's expert and an auditor's expert, the differences between these experts and the differing levels of work effort to be applied by the auditor in complying with the requirements of the ISAs when information to be used as audit evidence involves the work of these experts.

**Principles that have come out of the findings from the research above that have been incorporated into the proposed revised GS 005:**

15. Using the work of a management's expert needs to be scalable to the circumstances of an engagement so that the auditor's work to evaluate the work of a management's expert is commensurate with the risk of material misstatement associated with the financial statement assertion to which the experts work relates and the significance of the experts work to that assertion. To this end and consistent with PCAOB Release No 2018-006 Appendix 3 Discussion of Amendments Page A3-22-25, the guidance centres around the principle that more persuasive evidence (independent audit procedures) is needed as the risk of material misstatement increases, or where knowledge/skill/competency of the expert is not able to be assessed as high or where the management's expert lacks objectivity. PCAOB Release No 2018-006 Appendix 3 Discussion of Amendments Page A3-14/15 notes that the auditor's assessment that the company has the ability to influence the specialist, does not preclude the auditor from using the work of a company's specialist, whether employed or engaged, as audit evidence. Rather, it is a factor in determining the necessary audit effort to evaluate that specialist's work.
16. With these principles in mind the guidance statement has been significantly expanded in the areas of assessing knowledge/skill/competency and objectivity of a management's expert and the resulting impact of the auditor's assessment on the extent of auditor's procedures on the work of a management's expert.
17. Engagement Partners or personnel available in the audit firms today that can be included in the engagement team often have the expertise to evaluate the work of management's experts. The revisions explain that there may not always be the need to involve an auditor's expert and there is no requirement in the standard to do so. However, GS 005 recognises that whether or not to involve an auditor's expert is an area of professional judgement and the revised guidance statement provides extensive guidance to auditor's to assist in this area.
18. The revisions clarify the auditor's responsibilities for evaluating the work of a management's expert and avoids potential confusion that the auditor is required to reperform the work of the management's expert (PCAOB Release No 2018-006 Appendix 3 Discussion of Amendments Page A3-19). To this end, and consistent with the PCAOB standard, the revised guidance statement uses the word 'evaluate' rather than 'test'. Evaluate still requires independent audit evidence and assurance in relation to that work but not to the same extent as reperformance. The PCAOB standard reserve the use of the term "test" for procedures applied to company-produced information used by the specialist
19. The revisions increase auditor's attention on the work of management's experts and the guidance is significantly expanded across the guidance statement particularly in relation to evaluation of the work of the auditor's expert around methods, assumptions and data. Again, the guidance indicates that independent audit evidence and assurance in relation to that work is needed and accepting the work of a management's expert as audit evidence without independent audit procedures around that work would not meet the requirements of ASA 500 or ASA 540 and would not be following the guidance of GS 005 as this would not be considered 'assessing' the work of the management's expert.



20. As financial reporting frameworks continue to evolve and require greater use of estimates, accounting estimates have become both more prevalent and significant. As a result, the use of the work of management's experts also continues to increase in both frequency and significance. If a management's expert's work is not properly evaluated by the auditor, there may be a heightened risk that the auditor's work will not be sufficient to detect a material misstatement in accounting estimates. With the revised auditing standard on accounting estimates, the revisions to the guidance statement provide clear guidance on when a management's expert has been used in relation to auditing accounting estimates, with the updated guidance aligning to the requirements of ASA 540. The AUASB technical group have sought interpretation from the ISA 540 taskforce regarding the extent of audit procedures expected around data in relation to auditing accounting estimates, where data has been tested by a management's expert. Until such time as interpretation is received from the IAASB, GS 005 has been revised to reflect the words used in ASA 540.

### Next Steps

21. The Audit Technical Group (ATG) and the Chair of the AUASB met with ASIC on 3 June 2019. ASIC provided the ATG with some high level considerations but intends to review in detail the draft GS 005 and supporting documentation as provided by the ATG. The ATG will meet with ASIC in late June 2019 to obtain and consider ASIC feedback which will be then shared with the PAG.
22. The AUASB response to the IAASB's Proposed Strategy and Work Plan for 2020 – 2023, will include a specific reference for the IAASB to provide implementation guidance around the use of management's experts in the context of ISA 540 as this area has a direct link into GS 005.
23. The ATG intends to bring a draft of the revised GS 005 to the September 2019 AUASB meeting for AUASB consideration and input.



# AUASB Board Meeting Summary Paper

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**AGENDA ITEM NO.**        **5.0**

**Meeting Date:**            12-13 June 2019

**Subject:**                    Guidance Statement Revision Plan

**Date Prepared:**            29 May 2019

**Prepared by:**              Tim Austin/Jean You

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**Action Required**

**For Information Purposes Only**

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## Agenda Item Objectives

1. The objective of **Agenda Item 5** is for the AUASB to:
  - (a) Assess which AUASB Guidance Statements should be updated or withdrawn; and
  - (b) Determine the priority of the actions as a result of 1(a).

## Background

2. As agreed at April 2019 AUASB Meeting, the AUASB Technical Group (ATG) undertook an initial review of all AUASB Guidance Statements (GSs) issued prior to 2015 based on the following criteria:
  - (a) Have there been changes in relevant legislation/regulation. If so, are the changes administrative only or substantially change the subject matter or assurance requirements?
  - (b) Have there been changes in relevant auditing standards or reporting standards? If so, are administrative only or substantial impact on assurance procedures?
  - (c) Have there been changes in practice which require a Guidance Statement to be updated or no longer relevant?
3. The ATG's initial assessment of the guidance statements was provided to the AUASB out-of-session for feedback. Feedback from AUASB Members will be used to update the ATG's assessment table and influence the priority of GSs. The ATG's assessment table will be provided when each GS revision plan is brought to the AUASB for consideration.

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4. As outlined at the April 2019 AUASB Meeting, the ATG’s assessment did not include GS 005<sup>1</sup>, GS 009<sup>2</sup> and GS 012<sup>3</sup>, as separate projects to revise these guidance statements have already been initiated. In addition to this, the ATG has already commenced updating GS 008 *The Auditor’s Report on a Remuneration Report Under Section 300A of the Corporations Act 2001* to align the guidance statement with changes to the relevant legislation and AASB standards. A project plan for this Guidance Statement has been included as **Agenda Item 6**.

### **Matters to Consider**

5. Based on the ATG’s assessment of the changes in relevant legislation, standards and other factors for each GS, the ATG have prepared the attached table outlining the “ATG initial assessment” of the action (update or withdraw) and priority for each Guidance Statement.
6. Guidance Statements which are an immediate priority will have projects established and project plans brought to the AUASB for consideration and approval.

### **Questions**

1. Do the AUASB have any additional factors other than those identified by ATG for a particular Guidance Statement which should be considered?
2. Do the AUASB agree with the ATG’s initial assessment of action and priority for each Guidance Statement?
3. Which Guidance Statements do the AUASB consider to be the highest priority to revise?

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<sup>1</sup> GS 005 Using the Work of a Management’s Expert.

<sup>2</sup> GS 009 Auditing Self-Managed Superannuation Funds.

<sup>3</sup> GS 012 Prudential Reporting and Requirements for Auditors of Authorised Deposit-taking Institutions.



**Full List of AUASB Guidance Statements**

No.	Title	Issue Date	ATG Initial Assessment		
			Action	Priority	Comment
GS 001	<i>Concise Financial Reports Under the Corporations Act 2001</i>	May 2017	No Action	N/A	GS recently issued and relevant legislation and standards have not changed.
GS 002	<i>Audit Implications of Prudential Reporting Requirements for Registered Superannuation Entities</i>	Jan 2014	Update	Low priority	Relevant legislation and standards have changed. At present stakeholders have not requested this to be updated.
GS 003	<i>Assurance Relating to Australian Financial Services Licences issued under the Corporations Act 2001</i>	Sep 2015	Update	Low priority	Relevant legislation and standards have not changed. However, there is content relating to the “Reporting Entity” concept. Will need to be amended based on the AASB’s removing special purpose project.
GS 004	<i>Audit Implications of Prudential Reporting Requirements for General Insurers and Insurance Groups</i>	May 2013	Update	Low priority	Relevant legislation and standards have changed. At present stakeholders have not requested this to be updated.
GS 005	<i>Using the Work of a Management's Expert</i>	Mar 2015	Update	In-progress	Refer to <b>Agenda Item 4</b> .
GS 006	<i>Electronic Publication of the Auditor's Report</i>	Mar 2010	Withdraw	Low priority	ATG view that the issues in the GS no longer require a GS.
GS 007	<i>Audit Implications of the Use of Service Organisations for Investment Management Services</i>	Oct 2011	Update	Low priority	Relevant legislation and standards have changed.
GS 008	<i>The Auditor's Report on a Remuneration Report Under Section 300A of the Corporations Act 2001</i>	Mar 2010	Update	In-progress	Refer to <b>Agenda Item 6</b> .
GS 009	<i>Auditing Self-Managed Superannuation Funds</i>	Sep 2015	Update	In-progress	Separate project in-progress.
GS 010	<i>Responding to Questions at an Annual General Meeting</i>	Mar 2009	Update	High Priority	AUASB decision after auditor reporting standards issued to defer updating this GS due to other priorities.

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			ATG Initial Assessment		
No.	Title	Issue Date	Action	Priority	Comment
GS 011	<i>Third Party Access to Audit Working Papers</i>	Apr 2009	Update	Low priority	Changes appear to be administrative only. ATG view that updating to be done once new APES Code effective.
GS 012	<i>Prudential Reporting Requirements for Auditors of Authorised Deposit-taking Institutions</i>	Jun 2009	Update	In-progress	Separate project in-progress.
GS 013	<i>Special Considerations in the Audit of Compliance Plans of Managed Investment Schemes</i>	Aug 2009	Update	High Priority	Relevant legislation and standards have changed. ATG view that this GS should be initial focus to update for the introduction of Passport Funds.
GS 014	<i>Auditing Mortgage Schemes</i>	Aug 2009	Withdraw	High Priority	ATG view that GS should be withdrawn and content merged with GS 013.
GS 015	<i>Audit Implications of Accounting for Investments in Associates</i>	Nov 2009	Update	Low priority	ATG view that this GS requires administrative changes only. Accounting has not changed.
GS 016	<i>Bank Confirmation Requests</i>	Jun 2010	Update	High Priority	Relevant practice has changed. Stakeholders have requested this to be updated.
GS 017	<i>Audit Implications for Prudential Reporting Requirements of a Life Company</i>	Dec 2014	Update	Low priority	Relevant legislation has not changed. At present stakeholders have not requested this to be updated.
GS 018	<i>Franchising Code of Conduct – Auditor's Reports</i>	Jun 2015	Upcoming update <sup>4</sup>	Low priority	Update will be required in the future to take into account changes to relevant legislation based on Fairness in Franchising review. Defer until legislation amendments.
GS 019	<i>Auditing Fundraising Revenue of Not-for-Profit Entities</i>	Apr 2011	Update	High Priority	Relevant legislation and standards have changed. Stakeholders have requested this to be updated.
GS 020	<i>Special Considerations in Auditing Financial Instruments</i>	Mar 2012	Update	High Priority	Relevant accounting and auditing standards have changed. IAASB will update IAPN 1000 <i>Special Considerations in Auditing Financial Instruments</i> to reflect the revised ASA 540. ATG view that update be deferred to leverage IAASB work.

<sup>4</sup> The Parliamentary Joint Committee on Corporations and Financial Services released the report into Fairness in Franchising in March 2019. In this report, the AUASB is recommended to issue audit guidance for auditors to prepare audit reports in particular to marketing or cooperative funds. GS 018 *Franchising Code of Conduct – Auditor's Reports* may require revision after the prospective amendments on the relevant clauses of the Franchising Code of Conduct.

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ATG Initial Assessment					
No.	Title	Issue Date	Action	Priority	Comment
GS 021	<i>Engagements under the National Greenhouse and Energy Reporting Scheme, Carbon Pricing Mechanism and Related Schemes</i>	Nov 2012	Withdraw	Low priority	Relevant legislation and standards have changed. Clean Energy Regulator issues their own guidance which references relevant AUASB Standards.
GS 022	<i>Grant Acquittals and Multi-Scope Engagements</i>	Jun 2015	Update	Low priority	Relevant legislation and standards have not changed. Stakeholders have requested this to be updated. ATG view that the grant acquittals content should be split into a separate GS.

### **Material Presented**

Agenda Item 5.0                      AUASB BMSP Guidance Statement Revision  
 Agenda Item 5.1                      ATG Initial Assessment of Guidance Statements

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### **Action Required**

No.	Action Item	Deliverable	Responsibility	Due Date	Status
1.	Consider and provide feedback.	Approval	AUASB	13 June 2019	Pending

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# AUASB Board Meeting Summary Paper

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AGENDA ITEM NO. **6**

Meeting Date: 12 June 2019

Subject: GS 008 *The Auditor's Report on a Remuneration Report Under Section 300A of the Corporations Act 2001*

Date Prepared: 29 May 2019

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Action Required

For Information Purposes Only

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## Agenda Item Objectives

1. For the AUASB to approve the revision of GS 008 *The Auditor's Report on a Remuneration Report Under Section 300A of the Corporations Act 2001* as outlined in the project plan included as Agenda Item 6.1.

## Background

1. Refer to the project plan included at Agenda Item 6.1.

## Matters to Consider

2. Refer to the project plan included at Agenda Item 6.1.

## AUASB Technical Group Recommendations

1. The ATG recommends the approval of the Project Plan presented at Agenda Item 6.1.

## Material Presented

Agenda Item 6 AUASB Board Meeting Summary Paper

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Agenda Item            6.1    Revision of GS 008 *The Auditor's Report on a Remuneration Report Under Section 300A of the Corporations Act 2001* Project Plan

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**Action Required**

<b>No.</b>	<b>Action Item</b>	<b>Responsibility</b>	<b>Due Date</b>	<b>Status</b>
1.	To approve the project plan	AUASB	12 June 2019	O/S

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# Project Plan

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<b>Project Title:</b>	Revision of GS 008 <i>The Auditor's Report on a Remuneration Report Under Section 300A of the Corporations Act 2001</i>
<b>Project ID:</b>	XXX
<b>Project Objective(s):</b>	Revise GS 008 <i>The Auditor's Report on a Remuneration Report Under Section 300A of the Corporations Act 2001</i> (March 2010) to take into account changes in the legislation as well as the new form auditor's report.
<b>Priority:</b>	Low
<b>Issue/Reason:</b>	GS 008 requires updating to accommodate: <ul style="list-style-type: none"><li>• The change in Section 300A of the <i>Corporations Act 2001</i></li><li>• The change in AASB 124</li><li>• Changes in the auditor's report formats in ASAs 700 and 705</li></ul>
<b>Date Prepared:</b>	22 May 2019
<b>Date To Be Approved:</b>	12 June 2019
<b>Date Updated: (if applicable)</b>	

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## Project Objectives

To revise GS 008 *The Auditor's Report on a Remuneration Report Under Section 300A of the Corporations Act 2001* to accommodate changes in *Corporations Act 2001* and AASB 124 as well as to update the appendices with the latest auditor's report formats as illustrated in ASAs 700 and 705.

## Stakeholders

1. Assurance Practitioners
2. Relevant regulatory bodies:
  - a. Australian Securities and Investment Commission (ASIC)
  - b. Australian Securities Exchange (ASX)

## Background

Guidance Statement GS 008 *The Auditor's Report on a Remuneration Report Under Section 300A of the Corporations Act 2001* was issued in March 2010 and provides guidance to auditors conducting an audit of a remuneration report required under Section 300A of the *Corporations Act 2001*.

*Amendment in Section 300A of the Corporations Act 2001*

GS 008 is heavily referenced to Section 300A of the *Corporations Act 2001*, which was amended in 2015 to remove “disclosing entity” and substitute with “listed disclosing entity”.

#### *Amendment in AASB 124 Related Party Disclosures*

GS 008 refers to AASB 124 in the introduction section to highlight that certain disclosure requirements do not apply to disclosing entities that are companies. Following the change in Section 300A of the *Corporations Act 2001*, AASB 124 has removed any reference to “disclosing entities”.

#### *Updates on ASAs 700 and 705*

ASA 700 and ASA 705 was revised in May 2017 with the new form audit reports stemming from the Auditor Reporting project. These new form reports impact the illustrations provided in the appendix to GS 008.

### **Scope**

To revise the guidance statement for consistency with legislation and new form audit reports.

### **Risks/Issues**

To ensure that the changes in GS 008 are minimised so that no unnecessary costs are incurred by practitioners in modifying the engagement approach to address any amendments.

### **Action Plan**

1. Develop a project plan and obtain AUASB approval
2. Revise the guidance statement as outlined above.

### **Resources**

1 Project Manager

### **Timetable**

<b>Date</b>	<b>Description</b>
12 June 2019	Present Project Plan and obtain AUASB approval
August 2019	Finalise revision of GS 008
11 September 2019	AUASB meeting – Board to consider and approve issuance of revised GS 008
October 2019	Issue revised GS 008



# AUASB Board Meeting Summary Paper

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**AGENDA ITEM NO.**        **7.0**

**Meeting Date:**            12 June 2019

**Subject:**                    Audit Quality

**Date Prepared:**          28 May 2019

**Prepared By:**             Anne Waters

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**Action Required**

**For Information Purposes Only**

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## Agenda Item Objectives

1. To provide an update to and receive feedback from the AUASB on:
  - Future AUASB / FRC collaboration on Audit Quality;
  - Monitoring Group roundtable;
  - Reviews being conducted into audit quality - UK;
  - The Financial Markets Authority New Zealand survey on perceptions on audit quality; and
  - Observations and implications for the AUASB from the ACC and Investor surveys

### **A) Future AUASB / FRC collaboration on Audit Quality**

2. The FRC have an ongoing [Audit Quality Action Plan](#) and the AUASB are collaborating on some projects on this plan. The [Audit Quality in Australia: The Perspectives of Audit Committee Chairs](#) and [Audit Quality in Australia: The Perspectives of Professional Investors](#) reports have been issued. The FRC are now considering what are the next priorities on the action plan.
3. The AUASB have received funding to assist the FRC on audit quality initiatives and therefore will continue to provide resources to the FRC, as well as collaborating on initiatives which are appropriate to do so.
4. The following initiatives are planned / being considered:
  - Conduct another ACC survey and extend this to the ASX 500.

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- The objective of this survey is to determine if views of ACCs of the ASX 300 have changed since the previous survey (June 2018), and to extend this to the ASX 300 – 500.
- One of the findings from the previous survey was that the perceptions of AQ were higher at the ASX 1 – 100 than that for the ASX 200 – 300. This indicates there may be an issue at the smaller end of the listed entities. By extending the survey to smaller listed entities we will determine if there is an issue to address.
- The core questions of the survey will be replicated from the previous survey which focus on their perceptions of their auditor. Plus additional questions determined by the FRC and AUASB as areas of interest. Possible areas which are being raised internationally are which we are considering including in our survey are:
  - Do ACCs think auditors should provide assurance on other areas of the Annual Report such as the OFR?
  - Views on non-audit services provided by auditors.
  - Going concern
- This will be conducted in approximately November 2019.
- The FRC are considering other initiatives with the Audit Committee / director community. The objective is to provide best practice educative information on how to support audit quality. One option being considered is how to leverage off the [IOSCO Report on Good Practices for Audit Committees in Supporting Audit Quality](#) issued in January 2019. This could involve engaging with the Australian Institute of Company Directors and ASIC to distribute this.
- Engage with preparers of financial reports either through a survey or other methods to ascertain their perception of audit quality. Further planning is required however we have reached out to the G100 who are supportive of this initiative and will also approach the professional bodies.
- Providing feedback to ASIC on Audit Quality indicators they are considering using.

#### Action for the AUASB

Provide feedback on the proposed initiatives.

#### **B) Monitoring Group roundtable**

5. This is provided to the AUASB for information and no specific actions.

#### Background

6. In November 2017 the MG issued a consultation paper [“Strengthening the governance and oversight of the international audit-related standard-setting boards in the public interest”](#), proposing significant reform to the governance and oversight of the standard-setting process including the nature and roles of the PIOB and the Monitoring Group. This proposed reforms were to address concerns about the independence of the standard-setting process and its responsiveness to the public interest. Specifically the influence of the profession which is at least perceived to be too strong.
7. The AUASB provided a submission on this consultation paper expressing concerns about many of the proposals including that we have not observed any significant issues with the current governance and oversight arrangements and therefore did not agree that many of the reforms were required.

8. 179 comment letters received with mixed views. Due to the number of responses and the mixed views the MG are conducting further outreach and are developing a White Paper for further consultation which was supposed to be issued by now but hasn't.
9. The Monitoring Group representatives Gerben Everts (Outgoing-Chair) and Doug Niven (ASIC and MG representative) held a roundtable in Sydney on 15 May 2019, to discuss the feedback received on the consultation paper, and to gather further feedback. Whilst the White Paper is still being developed the MG presented their current views however they may change.

#### Key messages

10. Mixed messages between Gerben and Doug as to the progress of the White Paper and key decisions. Gerben says nearly done – Doug says late 2019 or early 2020. Doug inferred they are looking again at the whole proposal. Appears to be different views between the outgoing and incoming Chair Wes Bricker (SEC Chief Accountant).
11. Strong feedback from the attendees is that this needs to be resolved quickly and the uncertainty is having a negative impact on standard setting.
12. Funding is a big unresolved issue.
  - Gerben indicated the GPPC (big 6) had supported transitional funding until a longer term funding model was agreed. Regina Fickers (PWC) indicated this had not been agreed.
  - Participants at the roundtable all agreed: How can you move from the current model of funding through IFAC) by professional bodies and the large audit firms, to just the big firms? Inconsistent with the whole objective of the proposals.
  - MG's view: However other stakeholders not willing to commit to providing funding until they see that the standard setting process is working. This may take a few years to resolve. Hence why considering transitional funding model.
  - Attendees at the roundtable raised concerns that the cost of the proposed reforms would be significantly more than the current cost and that until the funding is resolved the ability to implement the reforms was questionable.
13. At this stage it appears that the MG are supporting a structure of the standard-setting boards of:
  - IAASB and the IESBA merged into one board.
  - The composition and number of board members is still being considered however it will certainly include more multi-stakeholder representation. The MG also strongly supporting having no practitioners on the board. Can be retired from their firms.
  - Ethical standards for whole profession. The attendees at the roundtable all agreed with this.
  - Expanded technical staff supporting them to “free” up the board members to focus more on strategic matters and alleviate concerns about the board not having capacity to deal with both matters. Concern raised by the participants at the roundtable is that this is hard to achieve and find the right people.
14. Role of PIOB - The MG are still considering
  - Oversight, funding and nominating role. Acknowledged there was wide spread support that they do not have the ability to veto standards.
  - Members will be elected and wont represent any particular constituency.

15. Closing messages:

- Move quickly and be aware of the negative consequences of uncertainty.
- Consult with stakeholders throughout process. Too important to get it wrong.
- Timetable? We need to know.
- Everyone acknowledges change is required but not as wholesale as those proposed.

**C) Reviews being conducted into Audit Quality - UK**

16. This is provided for the AUASB's information.

17. Four reviews being conducted which may result in significant change to the audit market in the UK:

1. Kingman Review on the FRC – scope, powers etc

- Report issued December 2018 with 83 recommendations including that the FRC be replaced with an independent statutory regulator, accountable to Parliament, called the Audit, Reporting and Governance Authority.
- John Kingman was also asked to consider whether there is any case for change in the way in which audits are currently procured, and audit fees and scope are set, particularly for major companies of public interest. He reported that in his personal view there is an argument there should be model whereby auditors are appointed by an independent body which also sets the audit fee. However this needs further consideration. The UK Government will consult on this.
- BEIS (UK government) have published a consultation paper on the Kingman recommendations [Independent Review of the Financial Reporting Council](#) which closes on 11 June 2019. Some recommendations are:
  - A review of the audit expectation gap – to be done in conjunction with the Sir Donald Brydon's review.
  - Strengthen the regulator's Audit Quality Review process including publishing individual firm results, employing more experienced reviewers, and extending to international component audits on a risk basis.
  - Regulator to provide a service to review accounting treatment of contentious matters before accounts issued (voluntary basis).
  - Corporate failure
    - Regulator develop a robust market intelligence function to identify emerging risks.
    - The review also recommended that a duty of alert for auditors to report viability or other serious concerns be introduced. This has not been recommended at this stage as requires more consideration.
    - Viability statements be reviewed to consider if needs to be enhanced, or removed.
  - Auditor's report to include "graduated" audit findings ie. findings described by the auditor on a range between those considered to be optimistic and those considered to be cautious. KPMG in the UK have introduced this and investors have given feedback that this provides greater insight as to how aggressive or conservative the accounting treatment is.

## 2. Competition and Markets Authority (CMA)

- The [Competition and Markets Authority \(CMA\)](#) published Audit Market Study on 19 April which identified concerns about the level of competition in the audit sector. Recommended:
  - Introduce measures to substantially increase the accountability of audit committee chairs for audit appointment and oversight.
  - Impose a joint audit regime giving firms outside the big 4 a role in auditing the UK's biggest companies.
  - Operational split between the big four's audit and non-audit businesses.
  - Regulator should monitor the health of the audit firms.
  - Government to respond by mid July 2019.

## 3. BEIS Parliamentary Committee – Future of audit inquiry

- Focus on the likely impact of the CMA market study and the Kingman review of the FRC. They have also commissioned the Brydon Review and are considering:
  - Effectiveness of audit – considering how the scope of audit might be widened to give the auditor more opportunities to express forward looking opinions and to report on more issues affecting stakeholders such as suppliers, employees and pension holders.
  - Conflicts of interest and auditor independence – welcomes the CMA's proposal to increase regulatory oversight of audit committees to ensure that audits are independent, robust and free of bias towards the Big Four. If this does not work, independent appointment of auditors by the regulator.
  - Recommended a segmented market cap and use of joint audits, on a pilot basis, for the most complex auditors to enable the non-big 4 to gain experience.
  - Recommend stronger audit quality reviews to be published in full.
  - Greater responsibility for non-financial directors for financial reporting.
  - Further consideration regarding greater internal controls and enhanced audit checks for banks.

## 4. Brydon Review – Role, Purpose and Scope of Audit

- Building on the findings to the Kingman and CMA's reviews and will report to the BEIS Parliamentary Committee.
- In response to perceived widening of the audit expectation gap. Also exploring is there an additional gap between the information users of audited accounts believe is needed and what is available to them through audited financial statements or other publicly available information.
- Objectives of the review to examine the existing purpose, scope and quality of statutory audit in the UK, in order to determine:
  - the needs and expectations of users of financial and non-financial corporate reporting;
  - how far the audit process and product may need to improve and evolve to meet the needs of users and serve the wider public interest;

- what specific changes to the statutory audit model and wider regulatory framework for audit may be needed to deliver this, including any changes to company law; and
  - whether other forms of business assurance should be developed or enhanced to enable shareholder and other stakeholders to assess better the future financial prospects and sustainability of companies.
- 1<sup>st</sup> consultation paper [Independent Review Into the Quality and Effectiveness of Audit](#) published (7 June 2019 deadline) include:
    - Who are the stakeholders?
    - Is the scope of an audit still appropriate and is it meeting existing requirements
    - Should the UK consider something similar to Sarbanes Oxley
    - Should auditors be providing assurance over more areas of the annual report
    - Impact of technology
    - Reform of auditor liability
    - More informative audit reports (consideration of graduated auditor reports)
    - Auditor’s role – capital maintenance
    - Should external auditors make greater use of the work of internal auditors?
    - How the possible use of experts from other professions or organisations might lead to more effective assurance.
    - Going concern
    - Fraud
    - Does the current regulatory assessment of quality drives particularly and possibly sub-optimal behaviours by auditors?

**D) New Zealand – survey on audit quality**

18. This is provided for the AUASB’s information.
19. The Financial Markets Authority New Zealand (New Zealand’s regulator) commissioned a research project to assess perceptions of audit quality in New Zealand and have issued a report [Perceptions of Audit Quality in New Zealand](#). This research project was conducted via a survey and interviews (15 people). A total of 357 people participated: retail investors (193), professional investors (10), directors and ACC (56), managers of entities (36), and auditors (62). The main findings were:
- The research identified reasonable levels of confidence in audit quality
  - highlighted that perceptions of audit quality are significantly more negative among investors than directors / ACC.

“Overall, participants felt that the primary reason for this difference in perceptions among the key groups related to the level of involvement or ‘closeness’ to the audit process. Since the auditors themselves, and the managers (and to a slightly lesser extent directors) are intimately involved in the



audit process and get to see first-hand the way audits are conducted, the way the auditor challenges the entity, the robustness of the discussions and debates, the quality and integrity of the auditor etc., participants felt it was not surprising these groups would trust the process. On the other hand, since investors do not get to see the audit process first-hand, people felt it was not surprising they were less trusting”\*.

- Independence and lack of competitions was a strong concern of investors and some directors.

20. The ATG observe that this was a different survey to those conducted by the FRC and the AUASB, and that over 50% of the participants were retail investors which we have not included in our surveys.

#### **E) Observations and implications for the AUASB from the ACC and Investor survey report**

21. This is to provide an opportunity for the AUASB to consider the results of the recently completed surveys and if there are any implications or actions for the AUASB.

22. The [Audit Quality in Australia: The Perspectives of Audit Committee Chairs](#) and [Audit Quality in Australia: The Perspectives of Professional Investors](#) reports have been issued.

#### **Observations from the ACC survey report:**

23. Overall ACCs are very satisfied with the quality of their auditor;

- Results are higher for the ASX 1 – 100 compared to the ASX 100 – 300.
- The lowest scored question was in relation to the auditor demonstrating innovation in the audit approach. This was consistent with commentary that some ACCs wanted to see more use of technology tools, and less basic manual testing.

24. Observations from the Investor survey report

- The following were the highest rated factors (top 3 and rated very closely) influencing perception of audit quality:
  - a) Quality of financial reporting disclosures
  - b) Reported episodes of fraud within audited companies
  - c) Quality of information contained with the auditor report (for example key audit matter).
- The value of audit was influenced by (top 3):
  - a) Quality of information contained with the auditor report (for example key audit matter)
  - b) Audit firm’s communication to the investors eg. transparency reports
  - c) Use of data analytics and artificial intelligence
- Priority for regulators and standard-setters (top 3)
  - a) Going concern judgements and disclosures
  - b) Developing and monitoring robust audit quality indicators

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\* Quote from *Perceptions of Audit Quality in New Zealand* - overall findings

c) Ascertaining appropriate level of assurance on Non-GAPP Financial Measures

Implications for the AUASB

25. The ACC survey identified that the perception of Audit Quality is lower for the auditor's of smaller listed entities. This is consistent with other feedback that the quality of the preparer decreases with the size of the entity and the ASIC inspection results for smaller audit firms.
26. The FRC and the AUASB plan to investigate this further through an extended ACC survey (refer above).
27. The ATG are also reviewing the AUASB's distribution list to identify auditor's of listed entities who are not receiving our communications and will add these to our lists.
28. The observations from the investor survey are consistent with feedback in other jurisdictions.
29. Going concern is an area being raised consistently and the UK FRC have an ED out on this at the moment proposing to increase the work and the reporting conducted by the auditor. The ATG are keeping a watching brief on this matter.
30. The enhanced auditor's report has received positive feedback which will form part of Auditor Reporting post implementation review.

Questions for the AUASB

Are there other implications or actions for the AUASB?

**Material Presented**

Agenda Item 7

AUASB Board Meeting Summary Paper



Double click to edit header, then click once; go to Treasury tab and insert desired committee banner

## AUDIT QUALITY BACKGROUND DOCUMENTS

The following documents are provided to FRC members as part of our actions with respect to the FRC Audit Quality Action Plan.

In particular, we sought to find professional and academic literature and any other source that might help define 'audit quality', other than ASIC Inspection Findings. You will note that the survey by the CFA Institute sought views on 29 Audit Quality Indicators which shows how widely audit quality is defined or characterised. The other documents also show many other interpretations and metrics of audit quality.

These documents are provided as background reading for further actions we might take. Any comments/suggestions that the FRC members might have at this stage are welcome.

### 1. 'CFA Institute Member Survey Report' (2018)

This report shows findings from a CFA Institute global member survey. There were 284 responses from predominately portfolio managers and research analysts (both buy side and sell side). Respondents were from America (55%), EMEA (27%) and Asia Pacific (18%).

The FRC has included in its FRC Audit Quality Action Plan a proposal to conduct a similar survey in Australia.

Key findings are found in:

- Table 1 (p 6) – **'Factors Influencing Investors Perceived Value of Audit'**
  - Insightful communication is the topmost factor influencing perceived value of audit,
  - Expanding the scope of audit and assurance services was assigned a reasonable level of importance.
- Table 2 (p 11) – **'Factors Influencing Investors Perception of Audit Quality'**
  - The survey sought views on 29 Audit Quality Factors.
  - Financial reporting and audit process outputs heavily influence investor perception on audit quality.
  - There was lower influence of input, process and context factors likely influenced by their low related observability.
- Table 3 (p 13) – **'What should be the audit standard setter and regulator priority'**
  - Strengthening independence of audit process is rated the topmost priority.
  - Developing ability to monitor audit quality is a high priority.
  - Support found for strengthening specific audit standards (accounting estimates, ongoing concern and subsidiary audits) and wider adoption of ISAs.
  - Support found for expanding assurance of non-GAAP financial measures and non-financial information.
  - Need for assurance on preliminary announcements was the lowest priority topic.

## **2. 'FEE Overview of Audit Quality Indicators Initiatives' (2016)**

This paper is an overview setting out audit quality indicators (AQIs) which have been adopted by nine different organisations worldwide, including regulators, oversight bodies, professional bodies and audit firms.

There is a table for each organisation showing their AQIs – a summary is difficult, but a table attempts that on p.5 summarising the 15 AQIs in multiple initiatives. The paper also provides insight into key differences between these AQIs, namely, if they are rules or principles-based, qualitative or quantitative, and whether reporting on these AQIs is made public or kept private.

Key findings include:

- AQIs differ quite significantly throughout different countries worldwide.
- The most popular AQI is the quantum of hours undertaken per person.
- Internal engagement quality reviews and external inspections are found in six initiatives.
- Number of audit staff per audit partner, years of experience, partner workload, and industry experience of audit personnel are found in five initiatives.

## **3. 'Understanding Audit Quality: Insights from Audit Professionals and Investors' (2014)**

This is a survey of audit professionals and investors to obtain their insights on audit quality.

Responses were received from 93 audit professionals and 102 investors.

Participants were asked to provide up to four definitions of audit quality. From the response, the author team created 18 categories for definitions of audit quality – see Figure 1 (p 52). Audit professionals appear to focus more than investors on the outputs and the opinion portion of the framework in defining audit quality.

Appendix 2 (p 41) shows a mapping of auditor and investor findings to PCAOB audit quality indicators. Highest rated were average years of experience, industry expertise and proficiency and training hours per audit professional.

Table 7 (p 59) shows publicly available signals of low audit quality as ranked by auditor and investors. The highest ranked by both auditors and investors was restatements, however, PCAOB reports of deficiencies was ranked 3<sup>rd</sup> by auditors and 20<sup>th</sup> by investors.

## **4. 'Audit Quality: Insights from the Academic Literature' (2013)**

This is a literature review of academic research on audit quality, in particular, summarising research on indicators of audit quality. Although US authors, it is an international paper and includes Australian research.

Despite this summarising more than two decades of research, there remains little consensus about how to define, let alone measure, audit quality.

Figure 2 (p 404) summarises indicators of audit quality under the categories, inputs, processes, outcomes and context.

## **5. 'Sharing experiences on audit quality' (2013)**

This is a selection of ideas and initiatives, provided by CA ANZ and APPC, to assist the promotion of consistent audit quality in Australia.

In December 2012, ASIC wrote to the six largest audit firms asking them to develop action plans to improve audit quality.

The focus of these plans was on:

- Culture of the firm;
- Experience and expertise of partners and staff;
- Supervision and review; and
- Accountability.

The six firms shared their experiences and this paper lists some of the initiatives being adopted.



# AUASB Board Meeting Summary Paper

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**AGENDA ITEM NO.**           **8**

**Meeting Date:**               13 June 2019

**Subject:**                       EER Assurance – Issuance of Phase 1 EER Consultation Paper – IAASB  
Seeking comments by 21 June 2019

**Date Prepared:**               5 June 2019

**Prepared By:**                 Marina Michaelides

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**Action Required**

**For Information Purposes Only**

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## Agenda Item Objectives

1. To provide the AUASB with the cover letter and the draft submission for comment on the EER Assurance – Phase 1 EER Consultation Paper due to the IAASB by 21 June 2019.

## Matters to Consider

### *Part A – General*

2. Please note the cover letter has been reviewed by Roger and Jo and includes Jo additional comments. Please note due to the timing of completing the draft and receiving these comments these changes have not been reflected in the detailed responses to the questions.
3. In addition the draft detailed submission has not been through internal QA processes and has not been reviewed in detail by Jo or the Chair. These are preliminary views of the ATG and those received from stakeholders at the outreach sessions held in May in both Melbourne and Sydney. Some points have been drafted from the AUASB viewpoint as these were matters raised in the issue paper that went to the April AUASB meeting and no significant issues were raised on these matters.
4. The AUASB are requested to again look at the questions being asked by the IAASB as per the submission and provide detailed comments.

### *Part B – NZAuASB*

1. NZAuASB have discussed their draft submission at their meeting held on 5 June 2019 and the AUASB and NZAuASB have raised similar key themes.

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*This document contains preliminary views and/or AUASB Technical Group recommendations to be considered at a meeting of the AUASB, and does not necessarily reflect the final decisions of the AUASB. No responsibility is taken for the results of actions or omissions to act on the basis of reliance on any information contained in this document (including any attachments), or for any errors or omissions in it.*

**Part C – “Compelling Reasons” Assessment**

1. N/A

The proposed changes conform with IAASB modification guidelines for NSS?

Y  N

**Material Presented**

Agenda Item 6

AUASB Board Meeting Summary Paper

Agenda Item 6.1

[EER Assurance – IAASB Consultation Paper \(Feb 2019\)](#)

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**Action Required**

No.	Action Item	Responsibility	Due Date
1.	Provide feedback to the ATG on key areas raised in the draft cover letter and submission to the IAASB Questions.	AUASB	13 June 2019

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21 June 2019

Marek Grabowski  
Chair of the Extended External Reporting Taskforce  
c/o International Auditing and Assurance Standards Board  
International Federation of Accountants  
529 5th Avenue, 6th Floor  
New York, New York 10017 USA

Dear Marek,

**AUASB Submission on the IAASB's Consultation paper: *Extended External Reporting (EER) Assurance***

The Australian Auditing and Assurance Standards Board (AUASB) is pleased to have the opportunity to comment on the IAASB's Consultation paper: *Extended External Reporting (EER) Assurance*.

The AUASB commends the IAASB's initiative to issue non-authoritative guidance as an appropriate outcome from the submissions received on the discussion paper issued by the IAASB for comment in 2016: *Supporting Credibility and Trust in Emerging Forms of External Reporting: Ten Key Challenges for Assurance Engagements*.

*The Australian perspective*

In Australia, EER continues to gain momentum in a voluntary market coupled with some form of assurance on this type of reporting. The ASX Governance Principles and Recommendations, revised in February 2019, now support the need for listed entities to have appropriate processes to verify the integrity of their corporate periodic reports and, as such, adequate credibility enhancing mechanisms in place to ensure that this occurs. These mechanisms may include external assurance provided by the listed entities' auditors. These initiatives are consistent with the direction being adopted internationally. Current academic research also supports the view that such credibility enhancing techniques are beneficial to market participants (Zhou, et al., 2018)<sup>1</sup>.

The AUASB and Australian Accounting Standards Board (AASB) see EER as a key strategic objective, acknowledging the role both reporting and assurance can play in enhancing credibility and trust, and recognising that the information needs of report users are at the forefront of this thinking. The AUASB continues to be very active in this area, not only through our representation on the IAASB Project Advisory Panel to the EER Taskforce through Jo Cain (current AUASB Member) and Nick Ridehalgh (stakeholder in our region), and as such considers it appropriate for the IAASB to continue to prioritise the finalisation of the guidance. This project enable's the IAASB to achieve its strategic vision through implementation of its three strategic objectives, i.e. the maintenance and development of robust assurance standards, the future proofing of the assurance standards by considering their continued relevance to stakeholders needs, and the importance of collaboration and cooperation with contributors to the financial reporting supply chain.

As part of the AUASB's strategic project on EER, the AUASB and AASB released a Bulletin on [Climate-related and other emerging risks disclosures: assessing financial statement materiality using AASB/IASB Practice Statement 2](#) in December 2018, which looks at both the reporting and assurance considerations.

The AUASB is also undertaking a survey of assurance practitioner's to gather views on:

- Types of credibility enhancing techniques currently being utilised for EER in the market place and reported publically; and

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<sup>1</sup> [Evaluating Combined Assurance as a New Credibility Enhancement Technique](http://aaajournals.org/doi/abs/10.2308/ajpt-52175) – Shan Zhou, Roger Simnett, Hien Hoang. Available at <http://aaajournals.org/doi/abs/10.2308/ajpt-52175>.



- To understand what other innovative assurance practices are being developed by practitioners that may be useful for enhancing credibility and trust in EER.

This survey will be cross jurisdictional and the AUASB will work with other National Standard Setters on its promulgation.

In formulating its response, the AUASB sought input from key stakeholders via two Round Tables in Melbourne and Sydney. These discussion sessions focused on EER assurance practitioners as the primary audience for this guidance, with professional accounting bodies, education bodies and preparers also represented to a lesser degree.

#### *Overarching comments*

The AUASB supports the development of this non-authoritative guidance to build credibility and trust in EER through more robust and consistent EER assurance. The follow through of the ten EER assurance challenges identified in the development of the guidance to-date is commended, not least the engagement of those experienced in the EER space on the IAASB EER PAP to provide insights to the IAASB EER Task Force. We thank the IAASB for consulting on this draft part way through to allow stakeholders not only to feedback on the draft thus far, but also to influence the remainder of the draft going forward. We note the progress made with respect to the following:

- **Purpose:** Clarity of purpose to apply ISAE 3000 (Revised) to a wide range of subject matter.
- **ISAE 3000 Requirements:** Alignment with the requirements of ISAE 3000 (Revised).
- **ISAE 3000 Terminology:** Consistent use of ISAE 3000 (Revised) terminology.
- **Target Audience:** Clarity of audience, namely assurance practitioners, with useful context relating to Report preparers not moved to the Appendix.
- **Examples:** Inclusion of examples to “bring the guidance to life.” NB: This remains an area for improvement.

However, it is the AUASB’s view that the guidance risks becoming quite a lengthy, complex document targeting multiple users which may not assist in it meeting its overall purpose. Stemming from this, the AUASB highlights a number of areas for further consideration by the IAASB during Phase 2. In consultation with our key stakeholders, the AUASB believes that addressing the following areas for improvement in the guidance will play a fundamental role in underpinning the credibility and trust of EER going forward:

- **Maintain Momentum:** Move quickly in line with the evolving nature of EER and to harness its current momentum.
- **Reporting Frameworks:** Whilst the guidance purports to be reporting framework-neutral, there is an overriding Sustainability Reporting and Global Reporting Initiative (GRI) theme. This manifests itself in significant gaps emerging with respect to relevant examples for other types of reporting, such as Integrated Reporting (IR). No examples are provided throughout the guidance in relation to the fundamental subject matter of an IR, such as the business model, strategy or value creation.
- **Examples:** Further work is needed on the examples provided throughout the guidance, including:
  - **Themed Examples:** Flow an example EER assurance process through the challenges, i.e. work through an example assurance engagement from start-to-finish, anchoring on an example relevant to each challenge. This may work well in the Appendix.
  - **Financial Alongside Non-Financial Examples:** Acknowledge that EER assurance practitioners will come from a wide range of backgrounds, some financial, some non-financial. With this in mind, include financial examples alongside non-financial, where possible.
- **Reasonable versus Limited Assurance:** Remains a “grey area” for EER assurance practitioners, with guidance needed. Although practitioners acknowledge coverage in ISAE 3000 (Revised), it does not meet their needs. Given the objectives of this guidance, this represents an opportunity to build greater understanding and consistency and a more robust approach.
- **Materiality:** Consideration of materiality in scoping an EER assurance engagement is widely accepted as a core component and is therefore suggested for inclusion in the guidance. Stronger

integration of risk into the materiality process is suggested as a key input. There is a need to encompass more than just impact in materiality determination, for example, IR relates to value creation. Finally, links to examples of materiality disclosure from Reports would add value.

- **Subjective Statements:** EER assurance practitioners highlighted a strong need for guidance in relation to the assurance or subjective statements, i.e. narrative, where evidence requirements may prove challenging to meet.
- **Sequence of EER Assurance Challenges:** The sequence in which EER assurance challenges are presented warrants further attention, such as bringing materiality further forward.
- **Flow Charts:** A flow chart of a typical EER assurance engagement would enhance the guidance at the start of Chapter 2: Overview of an EER Assurance Engagement. Then throughout the guidance, at the start of each chapter, a flow chart would assist to summarise what is covered in that chapter, with hyperlinks to each subsection from the flow chart for accessibility.
- **Hyperlinks:** Use of hyperlinks to more detailed examples within published Report would add value. In addition, reducing the amount of repetition of ISAE 3000 (Revised) through a suitable technology solution.
- **IASB Links:** Stronger links to the International Accounting Standards Board (IASB) project to update its IFRS Practice Statement 1 *Management Commentary* to ensure that the EER guidance will be fit for purpose across the broader corporate reporting suite.
- **Preconditions:** Avoid establishing too high a hurdle e.g. preconditions and the interplay between suitable criteria and internal controls which are iterative in nature, may result in the assurance process becoming a barrier to the development of EER.

The AUASB's detailed responses to the specific questions asked in the discussion paper are included in this letter as Attachment 1.

Should you have any queries regarding this submission, please do not hesitate to contact Marina Michaelides on [mmichaelides@auasb.gov.au](mailto:mmichaelides@auasb.gov.au)

Yours sincerely,

Roger Simnett  
AUASB Chair

# SUBMISSION OF THE AUSTRALIAN AUDITING AND ASSURANCE STANDARDS BOARD

## IAASB Consultation Paper – Extended External Reporting (EER) Assurance

### **Q1) Does the draft guidance adequately address the challenges for practitioners that have been identified as within the scope of the draft guidance developed in phase 1? If not, where and how should it be improved?**

Through outreach, feedback was received from a representative range of AUASB stakeholders, including assurance providers, reporters, professional accounting bodies and education bodies. Both this representative sample of stakeholders commend the IAASB's initiative to issue non-authoritative guidance as an appropriate outcome from the submissions received on the discussion paper issued by the IAASB for comment in 2016: *Supporting Credibility and Trust in Emerging Forms of External Reporting: Ten Key Challenges for Assurance Engagements*.

The AUASB highlighted in its response to the discussion paper on the Ten Key Challenges the ongoing challenge of limited versus reasonable assurance and the lack of understanding of the differences, as well as the wide ranging subject matter and criteria placing increased demands on both reporters and assurance providers, as worthy of greater attention. These points were again raised by AUASB stakeholders in the recent outreach sessions so are explored again below:

- There is also a lack of understanding by reporters and users of the difference between limited and reasonable assurance. The AUASB highlights an ongoing need for greater clarity regarding the difference between limited and reasonable assurance in terms of scope, work effort, output and value.

The AUASB's overall view and that of stakeholders is that the guidance risks becoming quite a lengthy, complex document targeting multiple users which may not assist in it meeting its overall objective. In addition, reducing the amount of repetition of ISAE 3000 (Revised) through a suitable technology solution would improve the usability of the guidance.

The issues identified below each sub-heading are areas where the AUASB consider the guidance would benefit from additional clarification for each identified challenge.

#### *Paragraphs 9-15 (scope of draft guidance)*

The AUASB considers that the following matters are relevant for the scope of the guidance:

- Some stakeholders would like to see more focus in the guidance on direct EER engagements as this is the most common EER engagement occurring in practice, however the guidance is predominantly drafted the principles of an attest engagement position.
- Applying appropriate skills in an EER assurance engagement will be considered in phase 2. Under the 'obtaining evidence' heading in Chapter 2, the consultation paper states that use of experts and the work of another practitioner are outside the scope of this guidance. In practice, the need to use experts or the work of another practitioner is a particular challenge where additional guidance and examples would be welcomed.

- Other information has been identified as outside the scope of the guidance. Other information that may be scoped out of an EER assurance engagement may be a particular challenge for practitioners. Additional guidance and examples would be supported.
- Guidance on how to make the criteria available to intended users would be useful. This may be addressed in the guidance to be developed on reporting. The requirement in ISAE 3000 (Revised) for the practitioner to evaluate whether the criteria are available to intended users may prove to be a challenge. It is unclear from paragraph 37 of the draft guidance as to whether this will be covered in Phase 2. Adding additional guidance in Chapter 3 and/or when developing guidance on reporting would be useful.

*Paragraph 25 (preconditions and the system of internal control)*

- Some stakeholders raised the issue around business strategy and the governance and oversight of the reporting process (para 71) not being documented or not being robust or even in existence, does the underlying premise of the EER guidance work in this scenario? The pre-conditions infer that the reporter needs to have governance and oversight of the reporting processes in place. If these processes are not documented or don't exist, will the pre-condition be met and can assurance over this information be given if there is no attestation by management?
- The AUASB questions the need for paragraph 47 a)-g) table in addition to the diagram in paragraph 46. It may be more useful to include the content in paragraph 47 and integrate it into the diagram. If paragraph 47 remains in the guidance, it could be enhanced with an example flowing through the different stages. For example: Could the greenhouse gas emissions of the entity be considered in terms of the contribution to climate change in comparison to peers in the sector?
- The distinction between what falls within assessing the “precondition” based on preliminary knowledge as opposed to performing detailed walk throughs or testing (i.e., the knowledge needed to make a complete assessment) is unlikely to be able to be made without starting to perform some detailed work which is a practical challenge. Performing work to understand the control systems (walk through procedures) is not typically done as part of the acceptance of an engagement in practice. This is part of performing the assurance engagement.

The focus on the ‘assurance readiness’ work is therefore a useful addition to the guidance (para 50-53). However, it is not clear where no assurance readiness work is performed, as to when this work would be performed i.e. on ‘preconditions’ or ‘engagement performance and testing’. We suggest that this delineation could be clarified in the guidance, to cater for types of EER where the ‘assurance readiness’ type of engagement are not practicable.

An overarching comment would be that the guidance on the preconditions seems to set a very high barrier to accepting an assurance engagement. Practically, when we consider that the practitioner may be unlikely to be able to reach a final conclusion on the suitability of the criteria, understand the materiality process and identify whether the internal control system is robust enough to be able to provide the evidence needed to conclude, until the practitioner has actually started to gain the understanding and do a system walk through that is traditionally performed as part of the assurance engagement.

We consider that the guidance may need to recognise even further that preparers are on a journey to evolve their reporting, and that the assurance practitioner needs to be able to evolve their methodology and procedures alongside them. As an entity moves from ‘readiness’ to ‘assurance’ some of the measures reported may not be assurable and some may not. It may however not be as clear as accepting and scoping the engagement accordingly, but rather may be more appropriate to report on this journey. This is something that may be best dealt with under the “Preparing the

Assurance Report' in Phase 2, i.e., by encouraging the assurance practitioner to include recommendations and findings in the assurance report.

If a readiness assessment is not performed separately, in many instances it is unclear how a practitioner would practically be able to determine whether the preconditions have been met, based only on a preliminary knowledge. Examples of where we consider that the delineation between 'precondition' and 'the work performed as part of the assurance engagement' could be made clearer are in the following paragraphs in the consultation paper:

- Response where the Preconditions are not Present (paragraph 75-78)
- Reliability of underlying data and source information (paragraph 107)
- Changes to criteria (paragraph 117)
- Consider process to prepare subject matter information (paragraph 128)

It should be acknowledged that there is a high level of judgement applied in the pre-conditions phase, based around discussions and reasonable assumptions that you will be able to access the evidence, and then the assurance practitioner would move into the planning phase where you perform more work are internal controls.

- The AUASB considers the draft guidance may imply there will need to be a significant amount of knowledge to determine whether the preconditions for an assurance engagement are met, due to:
  - the lack of maturity in many of the EER frameworks;
  - the range of frameworks available that are combined by preparers to prepare EER information; and
  - the need for some level of maturity in thinking and processes to prepare the EER information.
- The governance and oversight process as described in paragraph 71 should not only focus on the process to prepare but include a higher level of governance over what and how best to report. The governance and oversight process listed in paragraphs 71 could also refer to the process around seeking assurance over the EER information. In many instances, assurance is voluntarily sought, and may be for internal purposes only or for a select group of users. Clarification by the preparer as to why assurance is sought may assist the assurance practitioner in evaluating whether the preconditions for assurance have been met. (I.e., the level of assurance sought, what measures have been selected for the scope of the engagement).

Re-ordering paragraph 71 to bring Governance and Oversight before the paragraphs on reporting system could be another way to reinforce this. Also amending the diagram in paragraph 62 to have the governance and oversight as an overarching component may help to emphasize this point.

### *Paragraph 33 ('materiality processes')*

- The AUASB notes paragraph 164 would benefit from a couple of published examples, perhaps a best practice <IR> and a best practice Sustainability Report, showing how entities report their materiality process and the charts used to present their materiality results.
- Separating the terms and highlighting the difference between 'materiality' and 'materiality process' is helpful. The chapter on the 'materiality process' aims to provide practitioners guidance when considering an entity's 'materiality process', first by reviewing the context of the process and then reviewing the results of the process. Where this is applicable to the engagement, this would be part of the practitioner determining whether the criteria are suitable and would be performed as part of the agreeing the scope of an EER engagement.

- However there remains the matter that if a significant matter is omitted, then this may result in a material misstatement depending on the scope of the engagement. This cannot be limited to just a precondition for the engagement, but may be a conclusion after performing the assurance procedures.
- The guidance in Phase 2 on performance materiality will be challenging for EER. The NZAuASB experience with SPI Information identified that it is difficult to conclude on overall SPI information, as well as whether a material misstatement exists within one measure. These matters are not mutually exclusive. Coverage of financial materiality thresholds may assist, relating to percentage error may help assurance practitioners to understand this area.

*Paragraph 29 (suitability of criteria)*

- The AUASB is supportive of the guidance and examples developed to assist practitioners evaluate the suitability of criteria. In practice, this is a real challenge. The evaluation of completeness balanced against conciseness for understandability is a real challenge when dealing with highly principles based, non-specific reporting frameworks.
- Some stakeholders noted that there seems to be wide judgement applied on criteria in the guidance when undertaking an EER assurance engagement. It should be noted that in practice the determination of the criteria normally occurs through discussions between the entity and the assurance practitioner and not in isolation and it is somewhat of an iterative process.

*Paragraph 41 (narrative and future-oriented information)*

- A number of stakeholders raised some concerns around assuring narrative subject matter as follows:
  - What is the boundary of the subject matter: As an example on page 60, it is hard to define the narrative subject matter information. What does the 'minimal' mean? This is seen by stakeholders as one of the key challenges for EER and as such the AUASB encourage the IAASB to be carefully consider this further in Phase 2.
  - The examples in paragraph 187 on assuring narrative information matters may not provide a lot of practical guidance. With reference to the example on p.60 of the guidance, the underlying criteria of the narrative subject matter is vague.
  - The IAASB needs to ensure that the challenges around the subjectiveness of the statements on some subject matters are considered and the interplay with possible management bias. These areas need to be further addressed in the guidance.
  - Currently there are two views around assurance on narrative disclosures being the proposed Internationally, the first being the proposed International Standard on Auditing (ISA) (UK) 570 *Going Concern* on Going Concern - limited assurance and asking the auditor to do more and disclose more on going concern as compared to ISA 720 *Other Information* which is no assurance, only a read and consider for material inconsistencies. The IAASB will need to be cognisant of where this debate lands.
  - Practitioners may find the idea of assuring future oriented information difficult but were more comfortable to consider whether assumptions seem reasonable and whether the methodology used seems appropriate. This is work they currently perform in the audit of financial statements.

**Q2) Is the draft guidance clear and easy to understand, including through the use of examples and diagrams, and the way terminology is used? If not, where and how should it be improved?**

The AUASB suggests that the IAASB continue to streamline the guidance which may include: incorporating into an appendix, a continuous case study across all of the ten key challenges. This will bring the guidance to life and provide practical application on the 10 key assurance challenges for EER.

Stakeholders agreed that the technical language used in the guidance may be hard for report preparers or assurance practitioners from different backgrounds to understand. In Australia this is important because our definition of ‘assurance practitioner’ in ASAE 3000 is broader than in ISAE 3000 (revised) and encapsulates other assurance practitioners outside the accounting profession. This guidance should also be able to be used by preparers to understand further what the assurance practitioner expectations may be of them with regard to EER and the assurance process.

The AUASB also supports more examples throughout the guidance to illustrate application of the key assurance challenges in practice and not just limit these too financial examples. Consideration needs to be given when providing financial and EER examples alongside each other in the guidance, as this may draw the financial auditor undertaking an EER engagement away from focusing on the key assurance challenges specific to EER.

Refer to other recommendations for specific paragraphs throughout the submission.

**Q3) Do you support the proposed structure of the draft guidance? If not, how could it be better structured?**

The structure could be improved by clarifying the purpose of the document up front, i.e., guidance to be used in conjunction with ISAE 3000 (Revised) rather than a replacement for ISAE 3000 (Revised).

The AUASB considers the draft guidance could be streamlined by removing replication or paraphrasing of ISAE 3000 (Revised). The guidance is quite lengthy. To make the guidance more useful, the ATG would suggest limiting where possible, repetition of ISAE 3000 but rather concentrating on the examples and practical guidance on how to actually apply ISAE 3000 to EER. We recognise the importance of ISAE 3000 as the standard on which the guidance is based, but consider that an upfront statement that contextualises that this guidance is built on ISAE 3000, and should be read in conjunction with ISAE 3000 rather than repeating this message throughout may reduce the length of the document and provide the most value for the practitioner.

Comments from stakeholders on the guidance structure were as follows:

- more like a standard following ISAE 3000 rather than guidance around the 10 key assurance challenges for EER.
- currently not easily- accessible or ‘user-friendly’ to practitioners. The IAASB may need to consider a technology solution to enhance the accessibility of the guidance and links to ISAE 3000.
- they encourage the IAASB to further consider how to facilitate understandability of this guidance. This may be done once the final guidance has been issued through webinar’s or working with education bodies in this area.

- suggest that the IAASB consider bringing Chapter 8 *Considering the Entity's 'Materiality Process'* forward to Chapter 6 (after criteria and before Chapter 6 *Considering the System of Internal Control*).
- see the guidance as being somewhat more weighted toward sustainability and greenhouse gas reporting frameworks and would like to see some examples in the guidance or a case study that draws from other common EER frameworks.
- that a diagram or flowchart in the scope paragraphs that works through the EER assurance process from “cradle to grave” would be beneficial for navigating the guidance.
- Stakeholders generally agreed that while the chapters are useful for locating guidance on specific topics, they consider that the chapters may inadvertently remove the integrated and iterative nature of many of the considerations. The ATG therefore consider that the guidance would benefit from clarification as to when the practitioner is expected to do what. The current structure may be exacerbating the concern that the draft guidance blurs the line between the preconditions for an engagement and actually performing the engagement. In terms of structuring the guidance, this emphasis on the iterative nature of these evaluations and assessments on suitability of criteria, the appropriateness of the internal controls and the consideration of the materiality process could be further emphasized. The NZAuASB did a similar flowchart to highlight the iterative nature of evaluations for NZ AS 1 and they have provided this as an example in the appendix to their submission.

Draft



**Q4) Do you agree that the draft guidance does not contradict or conflict with the requirements or application material of ISAE 3000 (Revised), and that the draft guidance does not introduce any new requirements?**

Overall the ATG is supportive of the inclusion of guidance on the use of assertions, even though ISAE 3000 (Revised) does not deal with assertions. This support is based on consideration that the guidance may give rise to some useful examples to assist practitioners apply professional scepticism.

ISAE 3000 (Revised) is too broad to cover assertions related to all sorts of subject matter information however ISAE 3410 *Assurance Engagements on Greenhouse Gas Statements* addresses assertions. While the AUASB does not consider guidance on assertions is contrary to the assurance framework or requirements generally, it does acknowledge that EER still covers a very broad range of subject matter, which does raise challenges in whether the assertions described in the draft guidance are sufficiently broad to remain framework neutral.

**Q5) Do you agree with the way that the draft guidance covers matters that are not addressed in ISAE 3000 (Revised)?**

*Paragraphs 19-21 (matters not addressed in ISAE 3000 (Revised) and including details on the preparer's role and 'materiality processes')*

The AUASB is supportive of the inclusion of references to the preparer's role and the materiality process. The AUASB cautions against trying to cover too much in one document. Whilst guidance on the preparer's role is important, the guidance should not blur the role of the practitioner with that of the preparer.

*Paragraphs 24 and 26 (linking preconditions and the system of internal control)*

The AUASB agrees the guidance should draw a link between the preconditions and the system of internal controls. However, we consider the draft may imply an insurmountable hurdle to accepting an EER assurance engagement. Rather, a distinction should be drawn between the work effort based on a preliminary knowledge as opposed to performing detailed walk through's or testing typically performed during the assurance engagement.

The guidance on the preconditions seems to set a very high barrier to accepting an EER assurance engagement. Practically, we consider the practitioner may be unlikely to be able to reach a final conclusion on the suitability of the criteria, understand the materiality process and identify whether the internal control system is robust enough to be able to provide the evidence needed to conclude, until the practitioner has actually started to gain the understanding and do a system walk through, traditionally performed as part of the assurance engagement.

We consider the guidance may need to recognize even further that preparers are on a journey to evolve their reporting, and that the assurance practitioner needs to be able to evolve with them. On this journey some of the measures reported may be able to be assured and some may not. It may however not be as black and white as accepting and scoping the engagement accordingly, but rather may be more appropriate to report on this journey.

The AUASB recommends that Phase 2 should capture a more flexible way to report, not just a binary yes or no conclusion. Such flexibility may impact on the preconditions for accepting the engagement and "how much is enough" to enable a practitioner to accept an assurance engagement.

We have heard from IAASB roundtables in November 2018 that there is a general lack of understanding in the preparer community around controls and the preconditions for assurance. Where an entity voluntarily seeks assurance, they may be unsure of the need for controls and processes to support the EER, and therefore in practice, we understand that the current focus from assurance practitioners is in part the "assurance

readiness” phase, working with clients as they develop their EER, to assist them to focus on developing systems that will be “assurable” in the longer term as well as provide better quality information.

It will be a challenge to meet the preconditions for many EER assurance engagements due to the immaturity of data collation processes and reporting systems, as well as the lack of internal controls. The draft guidance provides some useful context on the performance of assurance readiness engagements in paragraphs 50-53. If a practitioner undertakes an assurance readiness engagement, they are typically moving into a developmental role and the issue of independence may be raised. Hence, their ability to continue in the role of assurance provider once assurance is sort may be questioned.

This is a costly exercise and may actually be a barrier for preparers when faced with voluntary reporting of EER. There may not be a declining cost over time either as reporting continuously evolves.

In Australia the other areas of focus is primarily limited assurance engagements on tightly scoped metrics i.e. GRI metrics or sustainability reports.

A key message that the IAASB have previously reiterated is that the assurance process should not be a barrier to innovation and should encourage preparers on the journey of EER rather than inhibit innovation in this space.

*Paragraph 36 (assertions)*

On balance, the AUASB are supportive of referencing possible assertions. As mentioned in response to Q1, the link between the qualitative characteristics described in a reporting framework, the practitioner’s evaluation of the suitability of criteria and the assertions could be clarified further.

**Q6) Do you agree that the additional papers contain further helpful information and that they should be published alongside the non-authoritative guidance document?**

The ATG found the information in the Four Key Factor Model for Credibility on page 77 very useful and would support its publication alongside the guidance.

The ATG found the material in the Background and contextual information section on page 72 to be confusing. It is unclear how much of this information will assist a preparer. If this material is published we would recommend that the examples are changed and that it is very clearly articulated how this guidance will assist them.

Areas we found especially confusing include:

- the distinction drawn between criteria and benchmarks (in paragraph 6). ISAE 3000 (Revised) defines criteria as benchmarks so separating these two is confusing. We understand that the measurement, recognition, presentation and disclosure bases are a part of the criteria.
- the example of the apple to illustrate the idea of “elements” and “qualities” we did not find useful. We consider the examples in the guidance to describe an element and its qualities, e.g. water quality will be more helpful for a broad stakeholder group as they relate to actual EER information. The apple example does not seem to clarify or assist.



# AUASB Board Meeting Summary Paper

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**AGENDA ITEM NO.**        **10.0**  
**Meeting Date:**            12-13 June 2019  
**Subject:**                    Not-For-Profit Sector Auditing and Assurance Issues  
**Date Prepared:**            28 May 2019

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**Action Required**

**For Information Purposes Only**

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## Agenda Item Objectives

1. The objectives of this paper are to:
  - (a) inform the AUASB of the activities undertaken by the AUASB Technical Group (ATG) to assist the Financial Reporting Council (FRC) with understanding, assessing and improving audit quality in the not-for-profit private sector; and
  - (b) seek AUASB feedback on whether any of the matters identified through the research impact on the AUASB and what actions, if any, should be taken by the AUASB.

## Background

2. In October 2018, a research report was presented to the AUASB by Jenny (Yitang) Yang an academic from UNSW. The report summarised key findings from the academic's research<sup>1</sup> regarding audits of large charities registered with the Australian Charities and Not-for-profits Commission (ACNC) including, auditor selection, financial reporting framework choice, auditor remuneration and auditor's opinions. The research also looked at assurance choices of medium charities.
3. In April 2019, the ATG hosted a session at which the academic who conducted the research presented their results to a group of relevant stakeholders which included the ACNC, Australian Accounting Standards Board (AASB) Staff, ATG, CPA Australia and CA ANZ.
4. The aim of the session was to discuss the implications of the research for the profession, to understand and assess possible indicators of audit quality in the NFP sector and determine appropriate actions to improve quality. The initial outcomes of the discussion were presented to the FRC at the May 2019 FRC Meeting and was intended to form part of the FRC's systematic review of audit quality in Australia.

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<sup>1</sup> Yang, Y. 2018, The Informational Value of Auditing, PhD dissertation, UNSW Sydney.

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*This document contains preliminary views and/or AUASB Technical Group recommendations to be considered at a meeting of the AUASB, and does not necessarily reflect the final decisions of the AUASB. No responsibility is taken for the results of actions or omissions to act on the basis of reliance on any information contained in this document (including any attachments), or for any errors or omissions in it.*

5. The paper presented to the FRC focussed on the audit quality implications of the research and how the research could assist the FRC with their mandate for audit quality under Part 12 the *Australian Securities and Investments Commission Act 2001*. Whilst broader audit quality implications are an important part of the AUASB's understanding of the assurance environment, this paper, **Agenda Item 9**, has been prepared for the AUASB with a focus on seeking feedback as to whether there are any direct implications for the standards and other pronouncements of the AUASB from the research.

### **Matters to Consider**

6. This section of the paper is structured to give the AUASB:
  - (a) a high level view of the key issues; and
  - (b) an ATG recommendation for AUASB action related to each issue.
7. Attachment 1 provides more detail regarding each of the issues identified including supporting data from the research.

### ***Key Findings from the Research***

#### *Who audits charities?*

8. 30% of all audits of large charities are conducted by the top 10 audit firms (by size). The remaining 70% of large charity audits are conducted by approximately 1,000 different auditors, of those 1,000 auditors greater than 50% of them are located in non-metropolitan areas.
9. Based on the last ASIC Audit Inspections Report, 6 files of smaller firms were reviewed in the 18 months to 30 June 2018. Anecdotally the error rate amongst those smaller files reviewed was significantly higher than the largest six and other national and network firms. This highlights the importance of the professional accounting bodies' auditor inspections and educative process in this sector.

### **ATG Action**

1. The ATG will use the auditor information to expand the database of auditors to ensure that the work the AUASB is doing is being communicated to all relevant stakeholders. No action for the AUASB.

#### *Observations from Auditor's Reports*

10. The research identified errors and non-compliance with the auditing standard on auditor reporting. This included errors in the identification of the financial reporting framework and in the reporting of modified auditor's opinions.
11. This may be an indication of underlying issues with audit quality, in particular, auditors not staying up-to-date with current requirements. This is supported by the research which identified 30 'subject-to' audit opinions which predate the current suite of AUASB standards.
12. The research also showed that there was significantly lower number of modifications and EOMs related to going concern than in the for-profit sector. This will require further investigation as to why and aligns with work being done on going concern for the public sector.

### ATG Action

2. Action related to identification of the financial reporting framework aligns with AUASB action in **Agenda Item 10**. The ATG is recommending issuing a bulletin to remind auditors of the requirement to evaluate whether the financial report adequately describes the financial reporting framework ATG and the additional requirements under ASA 800 where the financial report is a special purpose financial report.
3. With regards to going concern, the ATG will determine an appropriate action based on the outcomes of the Public Sector project as the factors related to going-concern issues are similar (withdrawn funding from government etc.). In the interim, the ATG will review the templates on the ACNC website and determine whether modified auditor's report templates are required.

### Audit versus Review

13. The research showed that 92% of charities who can elect to have their financial report either audited or reviewed, chose to have their financial report audited.
14. Whilst this does not raise any immediate concerns relating to audit quality, we are unsure why the occurrence of reviews is so low. Further work will be required to determine whether this is due to a lack of understanding of this option or other factors.

### ATG Action

4. No immediate action for the ATG.

### Questions

1. Does the AUASB agree with actions 1-4 outlined by the ATG?
2. Are there any other actions that the AUASB consider appropriate based on the research?
3. Does the AUASB consider further research is require in any of the particular areas identified, or related areas not covered by this summary?

### Material Presented

Agenda Item 10

BMSP NFP Auditing and Assurance Issues

### Action Required

No.	Action Item	Deliverable	Responsibility	Due Date	Status
1.	Review and provide feedback		AUASB	12-13 June 2019	

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## Attachment 1 – Key Findings from Research

*Note: The information in this attachment is not to be cited without the permission of the author.*

### The Auditors

A key insight from the research for the Working Group (ACNC, ATG, AASB, CPA and CA ANZ) was developing a better understanding of the assurance practitioners in this sector. Importantly, in the large charity auditor population there were approximately 1,113 different auditors, however as Table 1 shows below, 30% of all engagements were done by one of the top 10 audit firms in Australia.

Table 1 - Audits completed by the Top 10 firms in Australia.

	Entire		2015		2014	
	Frequency	Percent	Frequency	Percent	Frequency	Percent
<b>Big 4</b>	1,036	13.53%	547	13.53%	489	13.56%
<b>Next 6</b>	1,389	18.15%	722	17.84%	667	18.49%
<b>Sub-total Top 10</b>	<b>2,425</b>	<b>31.68%</b>	<b>1,269</b>	<b>31.37%</b>	<b>1,156</b>	<b>32.05%</b>

The population of auditors was further broken down into metropolitan and non-metropolitan auditors determined using postcode information. Approximately 644 (58%) of the 1,113 auditors were considered non-metropolitan. However, whilst non-metropolitan auditors accounted for 58% of the population of large charity audits they only accounted for approximately 34% of the audits.

The information about the population of auditors and who was undertaking the engagements led to a discussion by the Working Group about issues related to the viability of the profession in the future, in particular, in the context of the declining RCA numbers and the increasing complexity of the standards. The database of auditors is to be shared with all Working Group members to assist with future engagement.

The database of auditors is particularly useful for the AUASB to assist with collecting robust Australian feedback to respond to the [IAASB's Less Complex Entities Discussion Paper](#) released in late April 2019.

The Working Group discussion around the future viability of the profession was largely focussed on the qualifications of assurance practitioners in this area. The Accounting Professional Bodies raised, in the context of declining RCA numbers, whether a new qualification level below RCA could be introduced to assist with accessibility of competent auditors. It was noted however that this would require legislative change as the ACNC Act requires an RCA and would be considered when legislative changes resulting from the ACNC legislative review occur.

### Auditor's Reports

The research provided insights for the Working Group on:

- The number of errors in large charity auditor's reports; and
- The frequency and types of modifications being made to large charity auditor's reports.

#### *Errors in Auditor's Reports*

The research highlighted the prevalence of auditor reporting errors related to financial reporting framework choices, in particular, that a Special Purpose Financial Report (SPFR) had been prepared and the auditor's

report had failed to alert the reader to the fact that a special purpose framework had been used, which is a requirement of the auditing standards.<sup>2</sup>

**Table 2** below shows that of the 3,202 SPFR identified from the data, 12% of them did not meet the requirement of ASA 800 to draw the reader’s attention to the framework. This was largely an issue with entities outside the top 10 largest audit providers (the top 10 had an error rate of less than 1%).

The table also shows that 289 preparers did not appropriately disclose the financial reporting framework as required by accounting standards<sup>3</sup>. These findings are in-line with AASB research which shows the lack of appropriate disclosure of SPFR. The fact that the preparers did not appropriately disclose the financial reporting framework means that the auditor has also not met the requirements of the auditing standards to evaluate whether the financial report adequately describes the financial reporting framework<sup>4</sup>.

**Table 2 – Description of Financial Reporting Frameworks.**

Framework	Described in Financials		Described in Auditor’s Opinion		Difference	
	Frequency	Percent	Frequency	Percent	Frequency	Percent
SPFS	3,202	41.93%	2,852	41.42%	(350)	(12%)
GPFS	4,146	54.29%	N/A	N/A	N/A	N/A
Not disclosed	289	3.78%	N/A	N/A	N/A	N/A
<b>Total</b>	<b>7,637</b>	<b>100%</b>	<b>7,637</b>	<b>100%</b>		

Further to the basic auditor reporting errors it was found that 30 ‘subject-to’ auditor opinions were issued by 17 different large charity auditors. ‘Subject-to’ opinions have not been part of the assurance framework for many years and predate the current suite of AUASB standards. This may be indicative of the competence of some of the audit practitioners who work in this space and their lack of effort to stay up-to-date. A sample of the financial reports which had a ‘subject-to’ opinion were reviewed and on average these charities had greater than \$1.5m annual income.

The higher error rate amongst auditors outside the top 10 and the occurrence of ‘subject-to’ opinions was discussed by the Working Group. The immediate actions are to contact the auditors who issued the ‘subject-to’ opinions and to work with the ACNC and the professional accounting bodies to communicate to auditors that changes to the format of the auditor’s report were effective for financial reporting periods ended on or after 15 December 2016 and that templates and other supporting materials are available.

There is also a need to communicate to auditors the impact of the AASB’s proposed changes as part of their Financial Reporting Frameworks project which will require entities preparing SPFR to make an explicitly statement that they have complied with recognition and measurement requirements and therefore requires the auditor to sign off on whether the entity has met those requirement.

#### *Modifications to Auditor’s Reports*

As outlined in **Table 3** below, the most common reasons for a modified auditor’s report were:

- A limitation of scope due to the internal controls over cash donations and fundraising revenue; and
- Going concern either due to financial dependency or current financial situation (283 were unqualified opinions).

<sup>2</sup> See, ASA 800 *Special Considerations-Audits of Financial Reports Prepared in Accordance with Special Purpose Frameworks* paragraph 14.

<sup>3</sup> See, AASB 101 *Presentation of Financial Statements* and AASB 1054 *Australian Additional Disclosures*.

<sup>4</sup> See ASA 700 *Forming an Opinion and Reporting on a Financial Report*.

**Table 3 - Modifications to the Auditor's Report**

Modification (including EOM)	Frequency	Percentage
<b>Limitation of scope</b> (mostly related to controls over cash)	780	57.44%
<b>Going Concern</b> (Financial dependency)	214	15.76%
<b>Matters relating to the electronic presentation of FR</b>	168	12.37%
<b>Going Concern</b> (Current financial situation)	139	10.24%
<b>Significant Uncertainty over comparatives</b> (opening bal.)	90	6.36%
<b>Material Misstatement due to departure from Australian Accounting Standards</b>	58	4.27%
<b>Total modified opinions including EOM</b>	<b>1,358</b>	

Further work will be required to understand the modifications. The AUASB has on issue guidance statements that relate to the first and third modification reasons, GS 006 *Electronic Publication of the Auditor's Report* and GS 019 *Auditing Fundraising Revenue of Not-for-Profit Entities*. As part of the AUASB's current review of its suite of guidance statements work will be undertaken to understand whether there is a lack of awareness or deficiencies of those guidance statements.

The modifications research also provided some insight into possible accounting issues. As shown in **Table 3**, 58 opinions were modified due to non-compliance with Australian Accounting Standards (AAS). 52 of the modifications were for departures from a single AAS, 5 were for departures from multiple AAS and 1 was for not adopting AASs at all.

**Table 4** below shows that the most frequent departure from AAS related to inappropriate depreciation methods being chose and inappropriate disclosure of comparatives.

**Table 4 - Departure from Australian Accounting Standards**

Material Misstatement due to departure from Australian Accounting Standards	Frequency	Percentage	Most Common Reason
AASB 116 <i>Property Plant and Equipment</i>	15	23%	Inappropriate depreciation method
AASB 101 <i>Presentation of Financial Statements</i>	10	16%	Disclosure of comparatives
AASB 1004 <i>Contributions</i>	8	13%	Treatment of grants
AASB 137 <i>Provisions, Contingent Liabilities and Contingent Assets</i>	7	11%	Disclosure of leave provisions

The research also highlighted the significantly lower number of modifications to auditor's report of charities as a result of going-concern (qualifications and EOMs<sup>5</sup>) compared to for-profit entities. Research showed that in 2015, 34.73% of listed-entities auditor's reports had going concern related language (qualifications and EOMs) compared to 4.61% of large charities for the same period.<sup>6</sup>

The low prevalence of the going concern modifications in the charity population was not able to be clearly explained and further investigation is required by the Working Group. Regression analysis using the large charity data showed that the greater a charities' reliance on government grants, the higher the possibility of

<sup>5</sup> Where a material uncertainty exists over an entity's ability to continue as a going concern and management's disclosure of the material uncertainty is adequate, the auditor's report is unqualified but modified to include an Emphasis of Matter drawing the reader's attention to management's assessment of going concern.

<sup>6</sup> *Audit Reports in Australia 2005 – 2015: An updated analysis*, Carson et al, 2017



having going concern related language in the auditor’s report. **Table 5** shows that close to 50% of all large charities have a significant reliance on government grants.

**Table 5 - Reliance on government grants**

Government Grants	Frequency	Percentage
Charity has government grants which account for more than 50% of their total income	3,592	47%
Charity relies entirely on government grants	155	2%

**Audit versus Review for medium charities**

The research shows that that overall only 8% of medium charities chose to have their financial statements reviewed. As outlined earlier in the paper, medium charities are able to choose to have their financial report audited or reviewed under the ACNC legislation.

The review option was included in the legislation to be a ‘cheaper’ assurance option for medium charities to reduce the red-tape burden. The low number of medium charities choosing a review over an audit has been discussed previously by the ACNC, AUASB and the Professional Accounting Bodies as a key issue to address in this sector.

A new insight from the research was 31% of all Big 4 medium charity engagements were reviews, whilst only 6% of non-Big 4 medium engagements were reviews. Refer to **Table 6**.

**Table 6 - Medium charity averages**

Medium Charity Averages	Big 4		Non-Big 4	
	Audit	Review	Audit	Review
<b>All</b>	<b>288 (69%)</b>	<b>129 (31%)</b>	<b>5,291 (94%)</b>	<b>354 (6%)</b>
Total assets	4,166,531	5,617,744	1,607,878	2,134,046
Total liabilities	269,030	23,846	287,784	161,081
Total income	656,924	396,663	640,571	532,706
Total expenses	613,640	269,844	587,760	455,750
Fees (\$)	5,337	2,372	4,232	3,279

The reasons for this were discussed by the Working Group. One possible reason was that Big 4 are the most comfortable with the review standards and have a robust review methodology to support limited assurance engagements. The low number of review engagements also could be possibly linked with grant acquittal requirements. A large number of grants require an audit. For example, a government entity in NSW requires an audit for all grants over \$20,000 as well as an additional agreed-upon-procedures engagement to verify that all expenditure had supporting documentation and that competitive pricing was obtained for all expenditure over \$5,000.



# AUASB Board Meeting Summary Paper

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AGENDA ITEM NO. **10**

Meeting Date: 12 June 2019

Subject: Auditor implications arising from AASB ED's on Removal of Special Purpose Financial Statements

Date Prepared: 29 May 2019

Prepared by: Anne Waters

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Action Required

For Information Purposes Only

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## Agenda Item Objectives

1. To update the AUASB on the AASB's Conceptual Framework project and to discuss any actions for the AUASB including the implications for the AUASB framework and auditors.

## Background

2. At its meeting on 21 February 2019 the AASB decided to proceed with its proposal to remove the ability of for-profit private sector entities to publicly lodge special purpose financial statements (SPFS). The decision was reached after considering the results of its consultation paper, AASB Research Report based on commissioned academic research, user and preparer surveys, and feedback from regulators.
3. To do this the AASB will amend a range of AASB standards to remove the ability for for-profit private sector entities to self-assess their reporting entity status and prepare SPFS. All such entities will be required to prepare some form of general purpose financial statements. The Exposure Draft of this amendment (ED 1) is expected to be released for consultation in August 2019 and the standard to be issued by the end of the 2019 and effective for reporting periods beginning on or after 1 July 2020.
4. ED 1 will propose:
  - (a) to remove the ability to prepare SPFS for for-profit private sector entities which publicly lodge financial statements (with exceptions for some entities with non-legislative requirements to apply accounting standards, eg trusts);

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- (b) Transitional provisions to allow entities preparing GPFS under tier 2 for the first time need not restate its comparative information. Instead of full comparative information, the entities would provide the following information:
- (i) present two statements of financial position in accordance with Australian Accounting Standards (AAS), as at:
    - the beginning of the reporting period; and
    - the reporting date.
  - (ii) disclose its last SPFS statement of financial position as at the comparative period reporting date in the notes, with a description of the adjustments made for the statement of financial position at the beginning of the reporting period to be AAS compliant.
  - (iii) present two statements of profit or loss and other comprehensive income with the comparative periods as presented in its last SPFS (ie. not necessarily AAS compliant), but labelled clearly where the information is not AAS compliant.
5. As part of removing the ability to prepare SPFS, the AASB will also issue a second (but related) ED (ED 2), proposing to replace the existing Tier 2 Reduced Disclosure Requirements framework with a framework that will still require compliance with all recognition and measurement (R & M) requirements in AAS, including consolidation and equity accounting, but have further reductions in disclosures. ED 2 will be issued in July / August 2019 and effective for reporting periods beginning on or after 1 July 2020.
6. As the removal of SPFSs will not be effective for another 2 reporting periods, as an interim measure to improve consistency and comparability of SPFSs, at its meeting on 30 April 2019 the AASB decided to issue an ED (ED 3), proposing for-profit entities and not-for-profit entities within the scope of AASB 1054 *Australian Additional Disclosures* that prepare SPFS to disclose:
- (a) the basis on which the decision was made to prepare SPFS;
  - (b) whether they have subsidiaries and prepared consolidated financial statements, and if not consolidated, why not;
  - (c) where those financial statements consolidate subsidiaries, whether they have investments in an associate or a joint venture, and whether they have been accounted for in a manner consistent with AASB 128 *Investments in Associates and Joint Ventures*;
  - (d) whether the entity has or has not complied with all recognition and measurement (R & M) requirements of Australian Accounting Standards in preparing the SPFS; and
  - (e) if the entity did not comply with all of the R & M requirements, an indication of where they do not comply.
7. Compliance with R & M is not a current requirement of the AASs. ASIC's [Regulatory guide 85 Reporting requirements for non-reporting entities](#) says ASIC expects compliance with recognition and measurement however this is not a legislative requirement. ED 3 will not require entities to change their accounting policies, but to state whether or not their policies comply with all the R & M requirements in AASs.
8. ED 3 will be issued shortly (by the end of June) with a 45 day comment period, and is proposed to be effective for reporting periods ending on or after 30 June 2020. Entities affected are those lodging reports with ASIC, or required by the ACNC or other legislation to comply with AASB 1054.

## **Findings from the AASB Research Report**

9. The AASB commissioned academics to conduct a review of SPFS to gather information to inform them on the impact of the removal of SPFS. This research also looked at compliance with R & M requirements of the AASs.
10. At the time of finalising this paper the AASB Research Report had not been issued however the results were final and identified the following:
  - (a) 33.6% of SPFS for the for-profit entities did not state whether they were in compliance with recognition and measurement requirements of the AASs or not;
  - (b) 10% of SPFS do not comply with R & M;
  - (c) 14% of SPFS was unclear if they comply with R & M or not; and
  - (d) instances\* where the financial reporting framework was not clearly stated and described in the financial report. This is a consistent finding with the Not-for-profit sector research – refer agenda item 10.
11. The AASB research also found that most of the entities not stating compliance with R & M were audited by non-big 4 firms.

## **Actions for the AUASB?**

12. The AUASB Technical Group (ATG) considered the research conducted by the AASB and the EDs, to identify any actions for the AUASB including any changes required to the Australian Auditing Standards and whether guidance is required to assist auditors.

## **Does AASB research provides evidence of non-compliance by auditors with Auditing Standards requirements?**

13. The relevant Auditing Standards requirements:
  - (a) *ASA 210 Agreeing the Terms of Audit Engagements* paragraph 6 requires the auditor to determine whether the financial reporting framework is acceptable before accepting the engagement.
  - (b) *ASA 700 Forming an Opinion and Reporting on a Financial report*
    - (i) requires the auditor to conclude on whether the financial report is prepared..... in accordance with the applicable financial reporting framework (paragraph 12);
    - (ii) requires the auditor to evaluate whether the financial report adequately refers to or describes the applicable financial reporting framework (paragraph 15).
  - (c) *ASA 800 Special Considerations – Audits of Financial Reports Prepared in Accordance with Special Purpose Financial Frameworks* requires the auditor to comply with ASA 700, and in addition to the requirements of ASA 700:

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\* Actual % not able to be determined

- (i) obtain an understanding of the purpose of the financial report, the intended users, and the steps undertaken by management to determine that the applicable financial reporting framework is acceptable (paragraph 8);
- (ii) evaluate whether the financial report adequately refers to or describes the applicable financial reporting framework (paragraph 12);
- (iii) the auditor's report shall describe the purpose for which the financial report is prepared and, if necessary, the intended users, or refer to a note in the SPFR where that contains that information (paragraph 13);
- (iv) where management has a choice of framework, the explanation of management's responsibility will include reference to its responsibility to determine the applicable financial reporting framework is acceptable in the circumstances (paragraph 13);
- (v) alert users via an Emphasis of Matter in the auditor's report that it is a SPFR (paragraph 14); and
- (vi) the auditor's opinion refers to compliance with the AASs to the extent described in the basis of preparation in the financial report.

14. ATG Conclusion:

- (a) The acceptability of the financial reporting framework (ASA 210) – Compliance with R & M is the expectation of ASIC however is not a current requirement of the AASs. Therefore a financial reporting framework which is not in compliance with R & M or does not state whether they are in compliance, is acceptable. Also ASA 800 requires the auditor to understand the steps undertaken by management to determine the framework is acceptable, then ensure the financial report has been prepared in accordance with the financial reporting framework described in the financial report. The AASB research does not provide any evidence ASA 210 and 800 have not been complied with by auditors.
- (b) The financial reports where the financial reporting framework was not clearly stated and described is evidence of non-compliance with ASA 700 paragraph 15. This is consistent with findings in the Not-for-profit sector (agenda item 9) – refer below.

Impact of the EDs on the Auditing Standards

- 15. The removal of SPFS will require an amendment to ASA 800 to remove references to the *Corporations Act 2001* (Aus 6.1) and a relevant illustrative example. This will be amended in 2020. ASA 800 will still be required for financial reports using Special Purpose Frameworks for other purposes ie. not public lodgement.
- 16. ED 2 and 3 will not have an impact on the Auditing Standards.

Impact on audit practice and is guidance required to assist auditors with implementation?

- 17. The impact on auditor will depend on the current level of compliance with the AAS, and will be different for each set of current SPFS.
- 18. ED 1 and 2 - Auditors will be required to audit the GPFR, transitional adjustments and disclosures.
- 19. ED 3 - Auditors will need to ensure that the new requirements are disclosed in the financial report including the statement of (or not) compliance with R & M is included in the financial report, and that they agree with this disclosure.
- 20. Based on the AASB Research Report and the ATG discussions with practitioners, this will impact non-big 4 auditors / smaller audit firms who are auditing SPFS currently not stating compliance or

are not in compliance with R & M. These auditors will have to assess this statement and if they agree with this. This will result in more work for the auditors.

21. Communicating the new requirements to preparers of financial reports and auditors is important and will require communications from the AUASB, the AASB and the Professional Bodies.
22. The AUASB's communications will include advising auditors of the new requirements, encouraging communication with clients early to assess the impact on their financial report, and to plan for any additional time required to audit the transitional adjustments.
23. ATG Conclusion  
To address the issue discussed in paragraph 14 (b) and the findings from the Not-for-profit sector (agenda item 9) the ATG propose to issue an AUASB bulletin to remind auditors of this requirement. This Bulletin will also communicate the impact of the AASB's EDs.

#### Question for the AUASB

24. Do you agree with the ATG's conclusions about the impact of the AASB's EDs and actions proposed?
25. Is there anything else the AUASB can do to assist auditors in relation to these changes?

#### **Part B – NZAuASB**

26. This is an Australian specific matter.

#### Material Presented

Agenda Item

AUASB Board Meeting Summary Paper

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#### Action Required

No.	Action Item	Deliverable	Responsibility	Due Date	Status
1.			AUASB	12 June 2019	

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# AUASB Board Meeting Summary Paper

## AGENDA ITEM NO. 12

**Meeting Date:** 12-13 June 2019  
**Subject:** AUASB Draft Forward Agenda  
**Date Prepared:** 29 May 2019  
**Prepared By:** Tim Austin

The below table sets out the expected timing of when the AUASB's projects and other matters will be discussed at AUASB meetings for all planned dates until the end of 2019. As projects progress and circumstances change, further amendments to the below table will be required. Items highlighted are expected to require a larger allocation of agenda time and/or relate to critical decisions for the AUASB.

Meeting month # of days	2019		To be allocated
	Sep 1	Dec 2	
<b>AUASB Pronouncements</b>			
ASA 540 Implementation	✓		
Guidance Statements Revision Plans	✓		
GS 005 <i>Using the Work of a Management's Experts</i>	✓**		
GS 008 <i>The Auditor's Report on a Remuneration Report</i>	✓**		
GS 009 <i>Auditing Self-Managed Super Funds</i>	✓	✓	
GS 012 <i>Prudential Reporting</i>	✓	✓	
ASAE 3450			✓
Guidance on Review Engagements			✓
ASRE 2410 <i>Review Engagements</i>	✓		
<b>International Projects (Review of International Papers)</b>			
ISA 315	✓#	✓	
ISQM 1	✓	✓	
ISQM 2	✓	✓	
ISA 220	✓	✓	
ISA 600	✓	✓#	
ISRS 4400 – AUP	✓#	✓	
Emerging forms of External Reporting	✓	✓#	
Auditor Reporting PIR	✓	✓	
ISA 540 Implementation	✓	✓	
Auditing Less Complex Entities	✓	✓	
Audit Evidence	✓	✓	
Professional Scepticism	✓	✓	
IESBA Coordination (new code)	✓		
IAASB Strategy	✓	✓^	
Monitoring Group			✓
NSS Collaboration	✓	✓	
Report on IAASB Meetings	✓	✓	
<b>AUASB Strategic Projects</b>			
Audit Quality (including current issues)	✓	✓	
Use of Technology in the audit	✓	✓	

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Meeting month # of days	2019		To be allocated
	Sep 1	Dec 2	
<b>AUASB Strategic Projects (continued)</b>			
Auditor Reporting PIR	✓	✓	
Reporting and Assurance Frameworks	✓	✓	
Auditing Less Complex Entities	✓		
EER	✓	✓	
Public Sector	✓	✓	
<b>Other AUASB Priorities</b>			
Other Assurance Frameworks Bulletin	✓		
AASB Chair Update			✓
AUASB Technical work plan update	✓	✓	
Guest Presentations		✓	
AUASB Standards due process			✓
Restructured APES Code Amendment	✓**		
Joint AUASB/AASB session			✓
Joint AUASB/NZAuASB session			✓
<b>Corporate Reporting</b>			
FRC Reporting	✓	✓	
AASB-AUASB Annual Report	✓	✓	
AASB-AUASB Corporate Plan	✓		

**Notes:**

\* Anticipated finalisation of Australian Exposure Draft

\*\* Anticipated finalisation of Australian Pronouncement

# Consideration of IAASB fatal flaw (standard or exposure draft)

^ Consideration of IAASB Consultation Paper

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## APPENDIX 1 – SUPPORTING INFORMATION

### IAASB Forward Agenda International Standard key dates

Standard	Meeting	Outcome
ISA 315	Sep 2019	Anticipated finalisation of Standard
ISQM 1	Mar 2020	Anticipated finalisation of Standard
ISQM 2	Mar 2020	Anticipated finalisation of Standard
ISA 220	Mar 2020	Anticipated finalisation of Standard
ISA 600	Dec 2019	Anticipated finalisation of Exposure Draft
	Mar 2021	Anticipated finalisation of Standard
AUP	Sep 2019	Anticipated finalisation of Standard
LCE	Mar 2020	Anticipated finalisation of Feedback Statement
EER	Dec 2019	Anticipated finalisation of Exposure Draft (Ph2)
	Sep 2020	Anticipated finalisation of Pronouncement

### AUASB/IAASB Meeting timing

AUASB Meeting	IAASB Meeting
12-13 Jun 19	17 Jun 19
11 Sep 19	16 Sep 19
3-4 Dec 19	9 Dec 19

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4 June 2019

Mr Willie Botha  
Technical Director  
International Auditing and Assurance Standards Board  
529 Fifth Avenue  
New York, 10017  
USA

Dear Willie

### **AUASB Submission on the IAASB Proposed Strategy for 2020-2023 and Work Plan for 2020-2021**

The Australian Auditing and Assurance Standards Board (AUASB) is pleased to comment on the IAASB's Proposed Strategy for 2020-2023 and Work Plan for 2020-2021.

The AUASB is a non-corporate Commonwealth entity of the Australian Government, responsible for developing, issuing and maintaining auditing and assurance standards. The AUASB's role and mandate extends to liaison with other standards setters and participation in global standard-setting initiatives, so we have a very strong interest in the IAASB's Proposed Strategy and Work Plan and welcome the opportunity to comment.

The AUASB is very supportive of the overall approach the IAASB has taken when developing its Proposed Strategy for 2020-2023 and Work Plan for 2020-2021. In particular, as the National Standards Setter (NSS) responsible for the adoption and implementation of IAASB standards in our jurisdiction, we strongly endorse the IAASB's new Framework for Activities as a means for the IAASB to broaden and strengthen its capacity and capability to implement the strategic actions proposed in the Proposed Strategy and Work Plan. The AUASB is particularly pleased to observe the IAASB has explicitly recognised the role that NSS representatives have in adopting and implementing IAASB standards across the world and the NSS's capacity and capability to contribute to the global standard setting process. We would encourage the IAASB to continue the work it has already commenced at recent NSS meetings and deepen collaborations with NSS representatives in order to deliver the strategic actions contained within the Proposed Strategy and Work Plan.

Generally we consider the Proposed Strategy and Work Plan supports the IAASB's objective to develop and maintain robust international standards that contributes to enhanced engagement quality and consistency of practice throughout the world, and strengthened public confidence in the global auditing and assurance profession. We commend the IAASB and its staff on the structure and content of the document, and note the strong alignment with many aspects of our current AUASB Strategy and Work Plan.

In formulating our responses the AUASB has considered feedback from a range of Australian stakeholders, including formal discussions and deliberations about the IAASB's Proposed Strategy and Work Plan with AUASB members at recent AUASB meetings.

Our replies to the specific questions that the IAASB has requested feedback on in the Proposed Strategy and Work Plan are contained in the attached Appendix. However there are a number of headline matters which the AUASB would highlight as worthy of consideration and potential change to the IAASB's Proposed Strategy and Work Plan in our response:

### *Reducing the complexity of IAASB Standards*

The AUASB notes with concern that the auditing standards or exposure drafts recently issued or currently in development by the IAASB all contain greater complexity and detail than the extant standards they are replacing. This makes the implementation and application of these standards more challenging, and often results in increased costs for auditors of all types of entities.

Whilst we fully support the initiatives the IAASB has highlighted as potential responses to this issue in the recently released Discussion Paper on *Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Applying the ISAs*, we consider that there is a need for the IAASB to immediately address the impact this issue has on all auditors, not just auditors from small and medium practices, as part of its current Work Plan. This will likely require a different approach to the development of new and revised auditing standards, such as the amendments currently being proposed to the revised version of ISA 315 *Identifying and Assessing the Risks of Material Misstatement* following feedback from stakeholders on the IAASB's Exposure Draft for this standard.

The AUASB considers that the increasingly prescriptive nature of the requirements and application guidance in recently released ISA's and Exposure Drafts has had a negative impact on the ability of practitioners to apply professional judgement and increased the level of documentation required, with arguably no commensurate increase in the level of audit quality. Whilst acknowledging the IAASB is required to develop standards in the public interest that address the needs of all stakeholders, as part of its Proposed Strategy we consider the IAASB should strive for an improved balance between developing sector-neutral, principles-based standards for practitioners and the needs of regulators who oversee the audit environment in each jurisdiction. Failure to achieve this balance impacts not only the complexity, implementation costs and workability of the auditing standards themselves, but diminishes the value and confidence in the audit product and profile of the auditing and assurance profession as a whole.

The AUASB is encouraged that the IAASB's new Framework for Activities includes a specific Research Phase which may draw these issues and the appropriate responses out as part of the standards setting process, and whilst deliberations are still on going, we are very supportive of the proposed restructuring of ISA 315 presented at recent IAASB meetings.

We would encourage the IAASB to address this matter as its highest priority by:

- Potentially re-exposing any agreed restructuring to ISA 315 for public comment to gather feedback and, if supported, applying this revised approach to the ISAs to other proposed standards current in development (e.g. the Quality Management Standards, ISA 600)
- Evaluating whether the 'Clarity' principles of the auditing standards need to be refreshed and demonstrated with more transparency in the standard setting process; and
- Ensuring the responses to the LCE Discussion Paper are analysed and responded to as part of the updated IAASB Work Plan as soon as possible.

### *Addressing gaps between opportunities and challenges and the strategic actions, especially when it comes to use of technology*

The AUASB supports the 'environmental drivers' the IAASB has outlined in its Proposed Strategy and Work Plan on page 7, but in a number of areas believes the IAASB needs to more clearly articulate how these are going to be addressed in the proposed strategic actions contained in pages 10 – 13 of the publication.

In particular we believe the IAASB's response to consider the impact of the use of technology on an audit and the corresponding impact on the auditing standards requires greater consideration and a more granular response. We do not consider the current proposal to assess further implications on the IAASB's standards of evolving technologies used by entities and auditors under Theme B to be a sufficient response to this matter

considering its pervasive impact on the future of auditing and the potential for technology to revolutionise or disrupt the auditing profession.

*Greater focus on thought leadership and the value of audit*

The AUASB considers the strategic actions contained under Theme B of the Proposed Strategy require greater emphasis on what activities the IAASB intends to undertake to increase trust and confidence in auditing and assurance globally.

This could potentially be achieved through an increased focus on thought leadership highlighting the value of audit and assurance to the global economy by the IAASB as part of its global outreach activities. Also the IAASB should specifically address how the development of new and revised auditing and assurance standards enhances the value of auditing and assurance in further detail as part of the Research Phase of the IAASB's new Framework for Activities.

*Increasing complexity of accounting requirements and the impact this has on IAASB standards*

The IAASB's Proposed Strategy and Work Plan acknowledges that the increased complexity and detail of the auditing standards currently being observed is in response to a more complex business environment and more complex financial reporting requirements (for example, greater requirement for estimates and management judgments in accounting standards). Whilst the Proposed Strategy and Work Plan notes that there is a regular liaison with the International Accounting Standards Board (IASB) that provides input on auditability and verifiability of new and revised International Financial Reporting Standards, the AUASB considers that there should be greater focus by the IAASB on the impact this issue has on auditing requirements. In particular we would like the IAASB to consider what more could be done to clarify the evidentiary requirements and the responsibility of management and those charged with governance when it comes to the accounting requirements, with a view to making the auditing standards easier to understand and apply in those areas where complex accounting requirements are applicable.

To illustrate this point, accounting standards now more regularly require balances or transactions to be management's estimates that are based on complex calculations, external expert input or prospective financial information. Accordingly, stakeholders have requested auditing standards in turn require an auditor to source additional authoritative information or forecasts as evidence in order to be capable of obtaining reasonable assurance on these balances or transactions. These developments inevitably increase the cost and difficulty of the auditors' role at a time when the value and quality of auditors are subject to increased scrutiny. The AUASB would like the IAASB to assess ways in which they could work with the IASB to reduce the complexity of accounting requirements and thus make the requirements of the auditing standards easier for an auditor to comply with.

Should you have any queries regarding any aspect of the AUASB comments in response to the IAASB's Proposed Strategy and Work Plan, please do not hesitate to contact me or Matthew Zappulla at [mzappulla@auasb.gov.au](mailto:mzappulla@auasb.gov.au).

Yours sincerely,

Professor Roger Simnett AO  
Chair

## **Appendix – AUASB Responses to the IAASB’s Specific Questions IAASB Proposed Strategy for 2020-2023 and Work Plan for 2020-2021**

### **1. Do you agree with *Our Goal, Keys to Success and Stakeholder Value Proposition* (see page 6), as well as the *Environmental Drivers* (see page 7)?**

The AUASB agrees with the Goals, Keys to Success and Stakeholder Value Proposition outlined on page 6 of the IAASB’s Proposed Strategy for 2020-2023 and Work Plan for 2020-2021 publication (the Proposed Strategy). We are particularly pleased to observe the IAASB has explicitly recognised the role that NSS representatives have in its collaboration efforts and look forward to our continued cooperation and collaboration with the IAASB and its staff to support its mandate and the global standard-setting process.

When it comes to the opportunities and challenges faced by the IAASB, the AUASB supports the Environmental Drivers outlined on page 7 of the Proposed Strategy.

However as outlined in our covering letter and described in greater detail under our response to Question 2 below, in a number of areas the AUASB believes the Proposed Strategy has not clearly articulated how all of the Environmental Drivers are going to be addressed in the proposed strategic actions contained in pages 10 – 13 of the publication. In particular, we consider the layout of the Environmental Drivers should be updated to explicitly link to each relevant strategic action, as well as making it clear which of the Environmental Drivers each strategic action is intended to address.

### **2. Do you agree with *Our Strategy and Focus and Our Strategic Actions for 2020-2023* (see pages 8 to 13)?**

As outlined in our covering letter, there are a number of areas the AUASB believes the Proposed Strategy has not clearly articulated how all of the Environmental Drivers on page 7 of the publication are going to be addressed in the Strategy, Focus and Strategic Actions on pages 8 to 13 of the document.

- The AUASB considers that the IAASB’s Proposed Strategy should, as a priority, undertake as part of the strategic actions in Themes A, B & C, activities to reduce the complexity and improve the understanding of IAASB Standards. Whilst we fully support the initiatives that the IAASB has highlighted as potential responses to this issue in the recently released *Discussion Paper on Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Applying the ISAs*, we consider there is a need for the IAASB to immediately address the impact the issues in this Discussion Paper is having on all audits and not just auditors from small and medium practices as part of its current Work Plan. This will likely require a different approach to the development of new and revised auditing standards, such as the amendments currently being proposed to the revised version of ISA 315 *Identifying and Assessing the Risks of Material Misstatement* as a result of feedback from stakeholders on the IAASB’s Exposure Draft for this proposed standard with regards issues of scalability and proportionality. Whilst acknowledging the need for the IAASB to develop standards that address the needs of all stakeholders, including those who have responsibility for enforcing the auditing standards in the public interest, the AUASB considers that the increasingly prescriptive nature of the requirements and application guidance in recently released ISA’s and Exposure Drafts has had a negative impact on the ability of practitioners to apply professional judgement and increased the level of documentation required, with arguably no commensurate increase in the level of audit quality. Failure to achieve the right balance between public interest considerations and the practicality of the standards impacts not only the complexity and workability of the auditing standards themselves, but the confidence in the audit product and profile of the auditing and assurance profession as a whole. We would encourage the IAASB to address this matter as its highest priority by:
  - Potentially re-exposing any agreed restructuring to ISA 315 for public comment to gather feedback and, if supported, applying this revised approach to the ISAs to other proposed standards current in development (e.g. the Quality Management Standards, ISA 600); and
  - Ensuring the responses to the LCE Discussion Paper are analysed and responded to as part of the updated IAASB Work Plan as soon as possible.

## **Appendix – AUASB Responses to the IAASB’s Specific Questions IAASB Proposed Strategy for 2020-2023 and Work Plan for 2020-2021**

- The IAASB’s response to consider the impact of the use of technology on an audit and the corresponding impact on the auditing standards requires greater consideration and a more granular response. The AUASB does not consider the current proposal to assess further implications on the IAASB’s standards of evolving technologies used by entities and auditors under Theme B to be a sufficient response to this matter, considering its pervasive impact on the future of auditing and the potential for technology to revolutionise or disrupt the auditing profession.
- The AUASB believes the strategic actions contained under Theme B of the Proposed Strategy require greater attention to be paid to activities that increase trust and confidence in the auditing and assurance profession globally. We consider the IAASB, in collaboration with other relevant parties, should increase its focus on enhancing not only the quality of audit and assurance standards, but also identify and implement measures that enhance and convey the value and benefits of audit and assurance in the current global environment. There should be a greater emphasis from the IAASB on developing guidance and tools that not only support implementation by practitioners, but also inform all stakeholders about the critical role audit and assurance has in the global environment. This could potentially be achieved through an increased focus on thought leadership and the value of audit and assurance by the IAASB as part of its global outreach activities, as well addressing these matters in further detail as part of the Research Phase of the IAASB’s new Framework for Activities.
- The IAASB’s Proposed Strategy and Work Plan acknowledges that the increased complexity and detail of the auditing standards currently being observed is in response to a more complex business environment and more complex financial reporting requirements (for example, greater requirement for estimates and management judgments in accounting standards). Whilst the Proposed Strategy notes that there is a regular liaison with the International Accounting Standards Board (IASB) that provides input on auditability and verifiability of new and revised International Financial Reporting Standards, the AUASB considers that there should be greater focus by the IAASB on the impact that this issue has on auditing requirements and audit quality. Improvements in the clarity of accounting requirements have a positive impact on the quality of preparation of financial reports and clarify the role of both preparers and their auditors. In particular, we would like the IAASB to consider what more could be done to clarify the evidentiary requirements and the responsibilities of management and those charged with governance when it comes to the accounting requirements, with a view to making the auditing standards in certain areas easier to understand and apply in those areas where complex accounting requirements are applicable.
- The broadening of assurance offerings and the trend for stakeholders to demand different forms of information, as well as have this information assured, means the IAASB should place a greater focus in its strategic actions on developing assurance standards and guidance that meet user needs for external reporting beyond historical financial reporting. This includes considering that the current IAASB Assurance Framework (which segments the standards between those addressing ‘traditional’ forms of assurance over historical financial information and other non-financial or non-historical information) may no longer be fit for purpose and is under threat. As the information needs and reporting information demanded by stakeholders evolves, often being a hybrid of different types of subject matter, the distinction between ISAs and ISAEs is being challenged. Whilst the current project on EER Assurance Guidance is a good start, the AUASB considers this issue needs to have a greater focus from the IAASB going forward.
- The AUASB fully supports the IAASB’s intention under Theme A to prioritise the completion of its existing major audit quality enhancement projects underway and the intention to expand its activities focusing on the effective and efficient implementation of the ISAs in development or finalised over the 2015–2019 strategy period. In particular we believe there is an urgent need to allocate greater priority to the development of implementation materials for ISA 540, including the requirements relating to the use of the work of Managements Experts in connection with this standard. We would also encourage the IAASB to undertake the Post Implementation Review of the Auditor Reporting standards that became effective in December 2016 as soon as possible.

## **Appendix – AUASB Responses to the IAASB’s Specific Questions IAASB Proposed Strategy for 2020-2023 and Work Plan for 2020-2021**

- As part of the strategic action under Theme B to assess the need for changes in the auditing and assurance standards to address issues and challenges related to audit evidence, we encourage the IAASB to look at this topic comprehensively and carefully scope the nature and extent of updates required to respond to this issue appropriately. Whilst welcomed and considered a good start, current efforts focusing predominately on the update of ISA 500 are not considered sufficient by the AUASB to address the breadth of issues impacting how evolving technologies and automated tools impact the audit, as well as how the consideration of how professional scepticism applies to alternative sources of audit evidence. In particular the AUASB would like to see the IAASB (perhaps through its Audit Evidence Working Group) evaluate what changes may be necessary to the whole suite of Audit Evidence Standards in the IAASB Framework (e.g. ISA 505, 520, 530). Work the AUASB has undertaken locally has already highlighted a number of areas where the current Audit Evidence standards are seen as a barrier to implementation or acceptance by practitioners, regulators and other stakeholders when it comes to innovative audit and assurance techniques which increase the efficiency and effectiveness of the audit.
- Additional considerations the AUASB requests the IAASB should include as part of its strategic actions are to:
  - Review and update its standards governing the conduct of review engagements. With so many competing pressures on what constitutes the requirements for an audit, perhaps one solution is for the IAASB to reconsider how the different needs of stakeholders could be met by positioning review engagements as a genuine alternative to an audit rather than just a poorer option, which is how they are sometimes currently perceived. Additionally, the reporting requirements within the suite of review engagement standards need to be updated as soon as possible to align them with the changes made to the ISAs in respect of the auditor reporting project in recent years. The AUASB already has in progress a project, being performed concurrently with the New Zealand Auditing and Assurance Standards Board, to update its local version of ISRE 2410 with this issue in mind and we would be happy to share our efforts on this standard with the IAASB.
  - Specifically consider how the IAASB could utilise technology to increase the usability and availability of its pronouncements. As we have seen with the development of IESBA’s ‘eCode’, producing its standards and guidance in alternative formats using different technologies we believe will make the IAASB’s pronouncements easier for practitioners to access and interpret, which in turn would hopefully have a positive impact on compliance, audit quality and the efficiency and effectiveness of implementation.

### **3. Do you agree with the IAASB’s *Framework for Activities*, and the possible nature of such activities (see pages 11 and 12) as set out in Appendix 2 (see pages 19 and 20)?**

As described in our covering letter, as the National Standards Setter (NSS) responsible for the adoption and implementation of IAASB standards in our jurisdiction, we strongly endorse the IAASB’s new Framework for Activities as a means for the IAASB to broaden and strengthen its capacity and capability to implement the strategic actions proposed in the Proposed Strategy. We look forward to working, individually and collaboratively with the other NSS’s, with the IAASB on the different phases of the Framework. In particular we consider the IAASB should communicate in more detail how it wishes to engage with the NSS’s as part of the ‘Research Phase’ and working collaboratively with the IAASB on the ‘Implementation and Application of Standards’ described in Appendix 2. This would assist in determining where representatives from the NSS’s have the experience and capability to provide the greatest contribution.

In connection with Theme D of the strategic actions in the Proposed Strategy, the AUASB believes the IAASB’s Framework of Activities could be further enhanced by:

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- A reduction in the detail of meeting papers produced. This would assist in making the boards’ deliberations more accessible and transparent to interested stakeholders, particularly where English is not the native language; and
- The increased use of technology as part of the boards’ operations, such as the webcast of meetings and other standard-setting board events. This could improve efficiency, reduce costs, whilst also enabling greater collaboration with stakeholders across all parts of the world.

Additionally please refer to our additional comments in relation to the research activities phase of the framework in Question 5 below.

### **4. Do you support the actions that have been identified in our detailed Work Plan for 2020-2021 (see pages 15 and 16). If not, what other actions do you believe the IAASB should prioritize?**

As described in our response to Question 2 above, the AUASB fully supports the IAASB’s intention under Theme A to prioritise the completion of its existing major audit quality enhancement projects underway and the intention to expand its activities focusing on the effective and efficient implementation of the ISAs in development or finalised over the 2015–2019 strategy period. In particular we believe there is an urgent need to allocate greater priority to the development of implementation materials for ISA 540 and undertake the Post Implementation Review of the Auditor Reporting standards that became effective in December 2016.

Additionally the AUASB is pleased to see a continuing focus on Professional Scepticism in the 2020-2021 Work Plan. However the AUASB consider the actions relating to this need to be more clearly articulated rather than just being included as a generic project throughout the 2019, 2020 and 2021 years. In particular we do not support the activities of the Professional Scepticism Working Group being amalgamated into the Audit Evidence project as suggested in a footnote to Theme B on page 10 in the Proposed Strategy.

### **5. Are there any other topics that should be considered by the IAASB when determining its ‘information-gathering and research activities’ in accordance with the new Framework for Activities. The IAASB has provided its views on tentative topics to be included in its ‘information-gathering and research activities’ (see page 10)?**

As described in our response to Question 2 above, the AUASB has identified a number of additional topics not already included in the Proposed Strategy we consider the IAASB could focus on as part of its information-gathering and research activities over the 2020 – 2023 period, specifically by undertaking dedicated activities designed to:

- Increase trust and confidence in the auditing and assurance profession globally;
- Work with the IASB to clarify the evidentiary requirements and the responsibilities of preparers when it comes to complex accounting standards, which in turn would assist in the implementation of auditing standards and improve audit quality;
- Review the IAASB’s Framework to ensure it is producing assurance standards and guidance that meet current and future user needs for external reporting beyond financial reporting;
- Review and update its standards governing the conduct of review engagements; and
- Specifically consider how the IAASB could utilise technology to increase the usability and availability of its pronouncements

The AUASB supports the specific initiatives the IAASB has highlighted as its intended information-gathering and research activities under Theme D of its strategic actions and as part of the new Framework of Activities described in detail in Appendix 2.



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As part of our recent activities, the AUASB has developed an evidence-informed standard setting (EISS) strategy that directs AUASB activities to ensure that standard-setting deliberations and decisions are informed by relevant and reliable evidence. We have made reference to the IAASB’s Proposed Strategy when finalising this EISS and would welcome the opportunity to share our efforts in this area with the IAASB and other National Standards Setters.

Additionally, as part of our AUASB International Strategy (available on the AUASB Website at <https://www.auasb.gov.au/admin/file/content102/c3/AUASBInternationalStrategy-April2019.pdf>) the AUASB has committed to identify and support the development of evidence that informs the AUASB’s responses to International Auditing and Assurance issues. We welcome the IAASB’s intention to increase the consideration of findings from academic research, post-implementation reviews and other work already undertaken by NSS as part of its new Framework of Activities, and welcome opportunities to collaborate with the IAASB further in this area.