

AGENDA PAPER

Item Number: 5
Date of Meeting: 18 February 2019
Subject: Update on proposed revisions to Quality Control Standards

Action required For discussion For noting For information

Purpose

To provide the Board with an update:

- in respect of the exposure drafts approved at the International Auditing and Assurance Standards Board (IAASB) December 2018 meeting in relation to the proposed International quality control standards.
- the potential impact of these developments on relevant APESB pronouncements.

Background

In 2009, APESB and AUASB agreed in principle to take reasonable steps to ensure that the Australian quality control standards issued by the respective Boards are consistent with ISQC 1. APES 320 Quality Control for Firms (APES 320) incorporates the existing ISQC 1 issued by the IAASB, with changes made to accommodate Australian legislation and APESB's drafting conventions. These changes do not affect the substance of the requirements.

At the IAASB meeting held in New York on 10 – 14 December 2018 the IAASB approved the following Exposure Drafts and Explanatory Memorandums for release in early February 2019:

- ISQM 1 *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance Engagements and Related Services Engagements*
- ISQM 2 *Engagement Quality Reviews*
- ISA 220 *Quality Management for an Audit of Financial Statements*

The approval of the exposure drafts follows a long consultation process that commenced with an initial information gathering process in June 2014 and the establishment of a working group in October 2014. The working group released an *Invitation to Comment on Enhancing Audit Quality in the Public Interest* in December 2015, which resulted in the approval of a project plan in December 2016 (including updates to ISQC 1 and ISA 220).

Consultation continued through the use of a Quality Control Taskforce (QCTF) through 2017/2018 culminating with the approval of the exposure drafts at the IAAB December 2018 meeting.

The IESBA have maintained an active involvement through ongoing coordination activities with the IAASB, including extensive input in relation to the Exposure Drafts and the accompanying Explanatory Memoranda.

Key Changes from existing standard ISQC 1

ISQM 1

The proposed standard represents a complete revamp of the existing standard originally issued in October 2009 with the aim of enhancing audit quality by taking a far more proactive and preventative approach to quality management in order to meet quality control objectives.

The Exposure Draft introduces the concept of a system of quality management of organised into the following eight components:

- (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.

The exposure draft requires the adoption of a risk-based approach to quality and includes more robust requirements in relation to governance, leadership, and culture within a firm (including more accountability for firm leadership). Reference is made to a focus on a commitment to quality and the importance of professional ethics, values, and attitude throughout the firm (beyond a set of policies and procedures).

Enhancements have also been made in respect to relevant ethical requirements to better align with the restructured IESBA Code and to make requirements more principles-based.

The use of professional judgement and professional scepticism has been explicitly acknowledged as contributors to audit quality.

Consideration of resource requirements has been expanded beyond Human Resources to include whether a firm has appropriate IT resources, a reflection of an increased reliance on IT in the conduct of audit and other assurance engagements.

The exposure draft requirements have also been boosted in relation to the use of information systems to support more proactive communication (e.g. transparency reports) with external stakeholders,

Monitoring requirements of the existing standard have been expanded to include remediation with a shift in focus to the adoption of an inclusive monitoring system. There are also new requirements in relation the identification of deficiencies, including the use of root cause analysis as a means of evaluating their severity and pervasiveness and whether quality objectives have been achieved.

Guidance in relation to Network Firm issues has also updated to focus an individual firm's understanding of Network requirements (moving away from reliance on centralised management of quality risks).

The exposure draft introduces new definitions for deficiencies, external inspections, professional judgement, quality objectives & risks, and responses (in relation to a system of quality management).

The exposure draft includes a requirement to obtaining, at least annually, a documented confirmation of compliance with independence requirements from all personnel required by relevant ethical requirements to be independent.

Requirements relating to entities subject to an engagement quality review has been expanded to include “Audits of financial statements of entities that the firm determines are of significant public interest”.

Previous requirements in relation to Quality Control Reviews has been moved to ISQM 2 *Engagement Quality Reviews*.

ISQM 2

This proposed standard applies to all engagements for which an engagement quality review is required to be performed, or for which the firm determines such a review is an appropriate response to assessed quality risks, in accordance with proposed ISQM 1.

Whilst largely based on engagement quality review requirements of the existing standard (ISQC 1) the exposure draft introduces a number of additional requirements, including:

- Strengthened eligibility requirements that engagement quality reviewers have the competencies and capabilities, including sufficient time, to perform the duties assigned to them.
- Additional requirements in relation to individuals who assist the engagement quality reviewer (similar to the requirements relating to the engagement quality reviewer).
- Documentation requirements have also been expanded and require the engagement quality reviewer to prepare documentation that 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.

The exposure draft has also updated the terminology from engagement quality control reviewer, which has been changed to engagement quality reviewer in line with changes to ISQM 1.

ISA 220

The exposure draft has been updated to reflect the additional requirements and changes in terminology in ISQM 1 and ISQM 2.

Key considerations raised by IESBA

During the December 2018 IAASB meeting, a paper was tabled in relation to coordination activities with IESBA regarding these proposed standards and the matters of a significant nature discussed with IESBA as part of the coordination. The paper included discussion of the following matters:

- Proposed ISQM 1: Independence considerations in a network firm context.
- Proposed ISQM 1 and ISQM 2: Entities of significant public interest versus public interest entities (PIEs).

The Code defines the term “public interest entity” and uses it in the independence provisions. IESBA representatives suggested that, for purposes of proposed ISQM 1

and ISQM 2, the category of entities described as PIEs in the Code should be used in place of “entities that the firm determines are of significant public interest.”

It was argued that this would avoid inconsistency between the proposed standards and the Code. It was also noted that the Code already provides guidance as to general criteria (including those in the proposed ISQM 1 and ISQM 2) by which firms could determine whether to treat other entities as PIEs.

- Proposed ISQM 2: Threats to the objectivity of the EQ reviewer, including the cooling-off period for an engagement partner to be able to act as the EQ reviewer on an engagement.

Key considerations for APESB

APESB pronouncements

It is important to note that these international developments will impact the following APESB standards which address firmwide quality control and risk management:

- APES 320 Quality Control for Firms (APES 320), which is based on ISQC 1 was originally issued in 2006 and revised in 2009 and 2015. APES 320 mandates Firms to establish a system of quality control which provides Firms a reasonable of assurance that:
 - (a) Firms and their personnel are complying with applicable professional standards, ethical requirements, and legal and regulatory requirements, and
 - (b) reports issued by Firms and engagement partners are appropriate in the circumstances; and
- APES 325 Risk Management for Firms (APES 325), was originally issued in 2011 and revised in 2015 and 2017. APES 325 requires Firms to establish, monitor, document and communicate to their personnel a firm-wide risk management framework and related policies/procedures.

Staff Recommendation

The proposed standards and explanatory memoranda are expected to be released in early February 2019 for comment by 1 July 2019. Given the impact on the above pronouncements, APESB Staff recommend the following steps:

- APESB Staff collaborate with the AUASB Technical Staff and other key stakeholders, in relation to the proposed standards in order to inform a submission in relation to significant matters arising from the proposed standards; including the impact on Members in Public Practice in Australia.
- APESB Staff to identify potential implications to APESB pronouncements including APES 320 and APES 325, including the potential issue of a new pronouncement on engagement quality reviews.

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Date: 30 January 2019