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Basis for Conclusions: APES 320 Quality Management for Firms that provide Non-Assurance Services

Prepared by the Technical Staff of the Accounting Professional & Ethical Standards Board

BASIS FOR CONCLUSIONS:

Reissued APES 320 Quality Management for Firms that provide Non-Assurance Services

This basis for conclusions has been prepared by the Technical Staff of Accounting Professional & Ethical Standards Board Limited ("APESB") and approved by the Board of Directors of APESB. It is provided for the benefit of stakeholders to gain an understanding of the background to the reissue of APES 320 *Quality Management for Firms that provide Non-Assurance Services* (APES 320).

The basis for conclusions **does not** form part of APES 320 and is not a substitute for reading the Standard.

Background

The APESB originally issued APES 320 *Quality Control for Firms* in May 2006, and then revised it in May 2009, December 2015 and again in September 2019.

Extant APES 320 *Quality Control for Firms* (extant APES 320) incorporates the requirements and application material of the 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*, issued by the International Auditing and Assurance Standards Board (IAASB). Extant APES 320 also includes AUST paragraphs to reflect the Australian environment and a Scope and Application section in accordance with APESB's drafting conventions.

In December 2020, the IAASB issued ISQM 1 *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements* (ISQM 1), ISQM 2 *Engagement Quality Reviews* (ISQM 2) and ISA 220 *Quality Management for an Audit of Financial Statements* (ISA 220). ISQM 1 and 2 replace ISQC 1 and fundamentally change the way accounting firms are expected to manage quality for audits, reviews, other assurance and related services engagements.

The Auditing and Assurance Standards Board (AUASB) issued ASQM 1 *Quality Management for Firms that Perform Audits or Reviews of Financial Reports and Other Financial Information, or Other Assurance or Related Services Engagements* (ASQM 1), ASQM 2 *Engagement Quality Reviews* (ASQM 2) and ASA 220 *Quality Management for an Audit of a Financial Report and Other Historical Financial Information* (ASA 220) in March 2021 (effective 15 December 2022). ASQM 1 and 2 are the Australian equivalents of ISQM 1 and 2 and apply to the assurance practices of Australian firms.

APESB supports the focus of ASQM 1 and 2 on improving audit quality. However, APESB is not aware of evidence to suggest that extant APES 320 material is not fit for purpose for non-assurance services. Accordingly, APESB has determined to reissue APES 320 as a specific quality management standard for non-assurance practices of firms. As a result, the title of the Standard has changed from *Quality Control for Firms* to *Quality Management for Firms that provide Non-Assurance Services*.

APESB issued an Exposure Draft 05/21 *Proposed Standard: APES 320 Quality Management for Firms that provide Non-Assurance Services* (ED 05/21) on 15 September 2021 with a comment deadline of 26 November 2021. APESB received nine submissions, and in response to the comments received, APESB has made several changes to APES 320.

Changes to APES 320

The significant changes made to the reissued APES 320 (2022) include:

- new title *Quality Management for Firms that provide Non-Assurance Services*;
- revised scope to only apply to non-assurance practices of firms and high-level alignment of APES 320's elements to ASQM 1's components;
- amended structure to align to APESB drafting conventions and to simplify the Standard;
- removal of material specific to assurance practices;
- the requirement to establish and maintain a System of Quality Management in place of the system of quality control;
- a new definition of Engagement Output to better represent outputs from non-assurance services;
- *Human Resources* from extant APES 320 changed to *Resources*;
- a new element *Information and Communication*;
- guidance material on root cause analysis;
- a flowchart and table in Appendix 1 to demonstrate which quality management standards apply to firms depending on the services they provide; and
- a new Appendix 2 demonstrates the high-level alignment between reissued APES 320 elements and ASQM 1 components.

The following includes details of significant changes made and the key issues raised by respondents and stakeholders during the development of the reissued APES 320 and how APESB addressed them. APESB has also developed a *Mapping Table Reissued APES 320 compared to extant APES 320* to assist stakeholders to navigate all changes made to the Standard.

Change of title, scope and structure

The scope of the Standard has been revised to delineate that (refer to paragraph 1.10 and Appendix 1 of reissued APES 320):

- the non-assurance practices of firms are required to apply APES 320; and
- assurance practices of firms are required to comply with APES 210 *Conformity with Auditing and Assurance Standards*, which includes the quality management standards issued by the AUASB (ASQM 1, ASQM 2 and ASA 220).

Reissued APES 320 has established a high-level alignment between APES 320's elements and ASQM 1's components to assist hybrid firms that have both assurance and non-assurance practices to implement both standards. Extant APES 320 requirements and application material has been maintained as much as possible to minimise disruption for firms by enabling continued use of existing policies and procedures with minimal changes.

The Standard is scalable as firms need only comply with relevant requirements with scope for additional policies and procedures where necessary (paragraph 3.8) and highlights requirements that do not apply to sole practitioners with no professional staff (paragraph 3.9).

The Standard has been restructured and amended to align with APESB drafting conventions and paragraph referencing. Section 3 clarifies the firm's responsibility to establish and maintain a System of Quality Management, what the system consists of and the allocation and

possible delegation of responsibilities. Section 4 sets out requirements and application material for each element of the System of Quality Management.

Removal of assurance-based terminology and material

APESB has simplified the Standard and made it easier to navigate for firms of all sizes, including amending language to be more relevant to non-assurance services by removing assurance-based terminology and assurance-based roles or concepts including:

- Engagement Quality Control Review(er) has been replaced with 'appropriate reviewer' being terminology used in APES 110 *Code of Ethics for Professional Accountants (including Independence Standards)*;
- Reasonable Assurance has been replaced with 'reasonable confidence' being terminology used in APES 325 *Risk Management for Firms* (APES 325);
- Relevant Ethical Requirements has been replaced with Professional Standards, which is consistent with other APESB pronouncements; and
- Suitably Qualified External Person has been replaced with Service Provider, which is aligned with ASQM 1 and other changes in reissued APES 320.

Respondents were generally supportive of the changes in terminology noted above. One respondent believed that 'reasonable confidence' should be defined and have related application material. APESB notes that 'reasonable confidence' has been effectively applied in APES 325 since 1 January 2013 and is not aware of any concerns with using this terminology. Further, APESB is of the view that not defining 'reasonable confidence' improves flexibility and scalability for firms to exercise professional judgement, taking into account the firms' nature, circumstances and types of engagements.

Under extant APES 320, assurance practices are required to comply with the whole Standard, including all paragraphs boxed and designated 'Assurance Practices only'. These paragraphs relating to assurance practices have been removed from the reissued APES 320, significantly reducing and simplifying the Standard. The *Mapping Table Reissued APES 320 compared to extant APES 320* provides details of all extant APES 320 paragraphs that have been removed.

System of Quality Management

To assist with the high-level alignment between APES 320 and ASQM 1, all references to a system of quality control in extant APES 320 have been changed to a System of Quality Management throughout the reissued APES 320.

A new defined term System of Quality Management has also been included, which reflects the objective of the Standard to provide reasonable confidence that the firm and its personnel comply with professional standards, laws and regulations and engagement outputs are appropriate in the circumstances.

One respondent raised concerns that some paragraphs in ED 05/21 refer to establishing policies and procedures that provide reasonable confidence that the firm complies with the System of Quality Management and believe that the requirements should refer to the establishment of specific policies and procedures required for an effective system.

APESB is of the view that references to complying with the System of Quality Management (now a defined term) within paragraphs of the reissued APES 320 (for example, paragraph 4.28) simplified the drafting from extant APES 320 paragraphs which refer to all aspects of the objective of the system of quality control (for example, paragraph 56).

The use of reasonable confidence within individual paragraphs highlights the aim of those policies and procedures to provide firms with a level of confidence and not absolute certainty. Further, APESB believes that making certain policies and procedures more specific may reduce firms' flexibility in how they meet the requirements of the elements of the System of Quality Management.

A new definition of Engagement Output

Three respondents raised concerns that due to the varied nature of non-assurance services, there will not always be conclusions reached or the issuance of a report and that various paragraphs in APES 320 should be amended to reflect this. One respondent suggested wording for certain paragraphs and a proposed definition for 'Engagement deliverables' to replace reports.

APESB agrees that not all non-assurance services engagements result in forming conclusions or production of reports. This issue has been addressed with a new definition of Engagement Output. APES 305 *Terms of Engagement* has referred to 'Engagement outputs' since 2007 (although not a defined term) as 'reports or other anticipated outputs'. Further, 'reports or other anticipated outputs' has been used in APES GN 30 *Outsourced Services* since 2013.

The new definition of Engagement Output replicated below refers to reports and other outputs as specified in the Engagement Document (as defined in APE 305) and includes a non-exhaustive list of outputs from non-assurance services based on feedback from two respondents:

Engagement Output means the report or other output of an *Engagement* as specified in the *Engagement Document*. The Engagement Output may include, but is not limited to, a report, presentation, regulatory return or other completed form, advice, systems implementation, provision of managed services or project management outputs.

The *Mapping Table Reissued APES 320 compared to extant APES 320* provides details of all paragraphs in reissued APES 320 that have been amended to address this matter.

Network Firms

One respondent queried whether the proposed requirement in ED 05/21 for firms not to allow Network requirements result in the firm not complying with APES 320 was necessary due to other requirements making the firm responsible for the System of Quality Management.

APESB agrees that other requirements in the reissued APES 320 place the onus of compliance with the Standard at the firm and not network level. However, APESB believes it is important to highlight to firms that compliance with network requirements does not necessarily mean the firm will comply with APES 320. This matter is now particularly important as Australia will be in a unique position of having a quality management standard specific to non-assurance services.

To address this concern, APESB has changed paragraph 3.16 from a requirement to guidance material and made consequential editorial amendments.

Human Resources Element changed to Resources

The *Human Resources* element in extant APES 320 has been changed to *Resources* more broadly in the reissued APES 320 with a high-level requirement for firms to establish policies and procedures to provide reasonable confidence that the firm has sufficient and appropriate resources. This change also assists with the high-level alignment of APES 320 to ASQM 1.

Extant human resources requirements and application material has been maintained to minimise disruption for firms and enable existing policies and procedures to be utilised. No additional requirements are included in the reissued APES 320 regarding other resources. However, the Standard includes simplified guidance derived from ASQM 1 on technological and intellectual resources and service providers for firms to consider in respect of any policies and procedures that may be relevant to these resources.

New element Information and Communication

A new element, *Information and Communication*, has been added to the reissued APES 320, which also assists with the high-level alignment between APES 320 elements and ASQM 1 components.

A high-level requirement has been added for firms to establish policies and procedures that address obtaining, generating or using information and communicating internally and externally in a timely manner (paragraph 4.59) and related application material (paragraphs 4.60 to 4.64). This material has been derived from ISQM 1 but has been significantly simplified and made more applicable to non-assurance services.

Root cause analysis

Most respondents were not supportive of mandating root cause analysis in APES 320 as the cost of implementation would likely outweigh the benefits achieved, especially for smaller firms. Some respondents noted that root cause analysis is only one method of identifying deficiencies and specifying this method could be detrimental to other strategies that may be more appropriate.

Two respondents supported including root cause analysis in APES 320. One of these respondents believed guidance on root cause analysis should be included in APES 320 relevant to scalability and identified deficiencies due to the benefit of identifying underlying causes of deficiencies and will assist hybrid firms who are required to adopt root cause analysis under ASQM 1.

APESB agrees that mandating firms to adopt root cause analysis may be difficult and resource-intensive for firms to implement in relation to non-assurance services and acknowledge root cause analysis is only one method of identifying the underlying reasons for deficiencies.

To address this matter, APESB has added a potential appropriate remedial action for deficiencies (guidance paragraph 4.75 of APES 320) which is to take appropriate action to address the cause of the deficiencies, identified through, for example, but not limited to root cause analysis. In addition, a footnote has also been added, which refers members to the material in ASQM 1 on root cause analysis that applies to assurance practice and may also be appropriate for non-assurance services.

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Including root cause analysis as guidance instead of a requirement enables firms to use professional judgement and apply it if appropriate to their nature and circumstances and will be a methodology employed by hybrid firms.

Appendices 1 and 2 to assist hybrid firms

Appendix 1 of the reissued APES 320 includes a flow chart for firms in determining which quality management standards to comply with. A respondent was concerned that the new title of the Standard could result in less sophisticated users or new practitioners overlooking the Standard believing it does not apply to them. Another respondent believed retaining the extant title *Quality Control for Firms* could clarify the distinction between APES 320 and ASQM 1.

APESB believes the new title delineates APES 320 for non-assurance services from ASQM 1 & 2 applicable to assurance practices and makes it clear from the outset which services are covered by the Standard. However, to address the respondents' concerns, a table was added to Appendix 1 with a non-exhaustive list of non-assurance services covered by APES 320 and engagements provided by assurance practices which are outside the scope of APES 320.

During the exposure process an issue was raised with respect to Agreed-Upon Procedures (AUP) Engagements as there are circumstances where AUP Engagements are performed by Non-Assurance practices. Some respondents were concerned whether in these circumstance the Non-Assurance Firm will need to adopt ASQM 1 for these engagements. However, it should be noted that paragraphs Aus 3.1 and A5 of ASRS 4400 *Agreed Upon Procedures Engagements* supports the position adopted in Appendix 1 that a non-Assurance firm can perform AUP engagements and use APES 320 as their Quality Management standard.

A new proposed Appendix 2 demonstrates the high-level alignment between proposed APES 320 and ASQM 1 with paragraph references for elements and components of the standards.

Appendices 1 and 2 will assist hybrid firms to implement APES 320 and ASQM 1.