Workshop on ISQC 1 and ISA 220

(as per IAASB's ISQC and ISA Handbook 2012)

18 February 2017

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New Terms, New Approach

- System of quality control
- Elements of a system of quality control
- Leadership responsibility
- Written confirmation of compliance
- Integrity of the client
- CPD and coaching
- Consultation on difficult or contentious matters
- Differences of opinions
- Engagement quality control review (EQCR)
- Engagement documentation (60-day rule)
- Retention of engagement documentation
- Monitoring
- Cyclical inspection of completed files (quality assurance review, QAR)
- Complaints and allegations

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Today's Agenda

Overview

ISQC 1 (Quality Control for a Firm)

ISA 220 (Quality Control for a Job)

Simple but Comprehensive

Critical and Contentious Issues

Templates and Examples

Supplemented by *Guide to Quality Control for Small and Medium-Sized Practices*, Third Edition, 2011

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Today's Agenda

Overview

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Overview

- ISQC 1 – 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
- ISA 220 – International Standard on Auditing 220: Quality Control for an Audit of Financial Statements
- The ISQC 1 and the ISA 220 covered today are in the 2012 Handbook containing the complete set of International Auditing and Assurance Standards Board's (IAASB) pronouncements on quality control, auditing, review, other assurance and related services, a glossary of terms, and a preface to the international standards, as well as the non-authoritative International Auditing Practice Notes (IAPNs).
  - This handbook replaces the 2009 edition of the Handbook.

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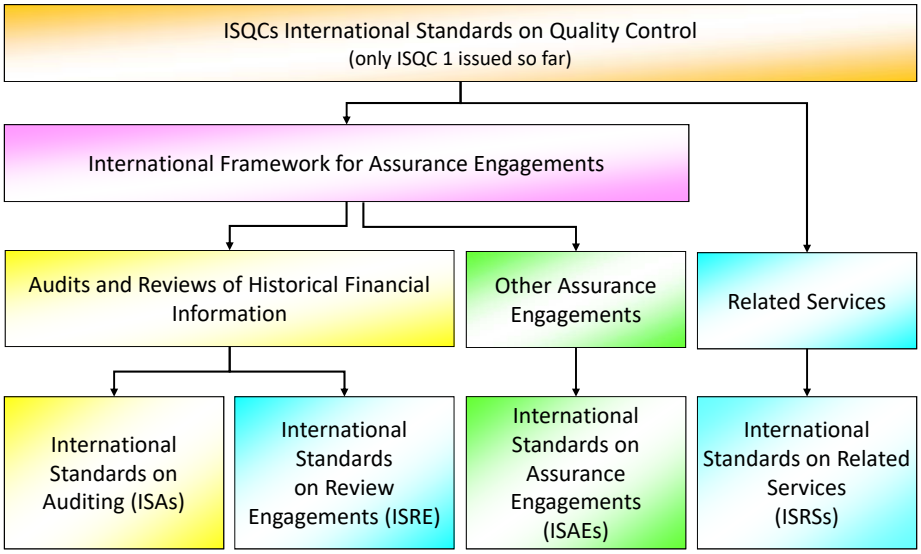
Overview



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Today's Agenda

ISQC 1 (Quality Control for a Firm)

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ISQC 1 – Introduction

ISQCs International Standards on Quality Control
(only ISQC 1 issued so far)

- ISQC 1 *Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements*
  - to deals with a firm's responsibilities for its system of quality control for
    - audits and reviews of financial statements, and
    - other assurance and related services engagements.
- ISQC 1 is to be read in conjunction with relevant ethical requirements.

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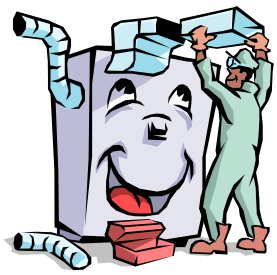
ISQC 1 – Introduction

What is Quality Control?

- ISQC 1 states that:
  - A system of quality control consists of
    - policies designed to achieve the objective set out in ISQC 1.11 and
    - the procedures necessary to implement and monitor compliance with those policies.



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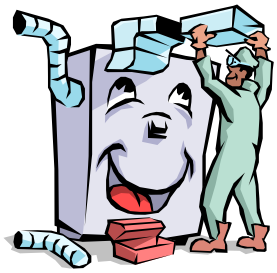
ISQC 1 – Introduction

What is Quality Control?

- **Objective** as stated in ISQC 1.11
  - The objective of the firm is to establish and maintain a system of quality control to provide it with reasonable assurance that:
    - (a) The firm and its personnel comply with professional standards and applicable legal and regulatory requirements; and
    - (b) Reports issued by the firm or engagement partners are appropriate in the circumstances.



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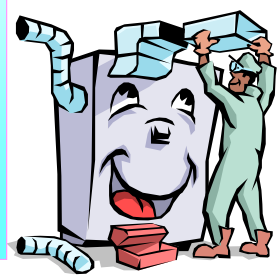
ISQC 1 – Introduction

What is Quality Control?

- High quality work reduce the risk of engagement failure and the CPA firm being sued for negligence.
- High quality of work will minimize the occasions when review of work reveals weaknesses in the audit and assurance approach, thus resulting in additional time spent by professional staff (this increases the cost of an engagement).
- High quality work will increase engagement efficiency, thus reducing costs.
- High quality work will also ensure good records of work so that they can be produced as evidence in a court of law if required.
- Finally, high quality work will give confidence to the client of the standard of service provided (higher client satisfaction).



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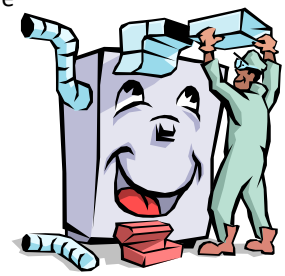
ISQC 1 – Introduction

- ISQC 1 applies to all firms of professional accountants in respect of
  - audits and reviews of financial statements, and other assurance and related services engagements.
- The nature and extent of the policies and procedures developed by an individual firm to comply with ISQC 1 will depend on various factors
  - such as the size and operating characteristics of the firm, and whether it is part of a network.



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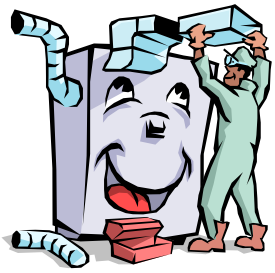
ISQC 1 – Introduction

- ISQC 1 contains the objective of the firm in following the ISQC, 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, as discussed further in ISQC 1.8, and introductory material that provides context relevant to a proper understanding of the ISQC, and definitions.



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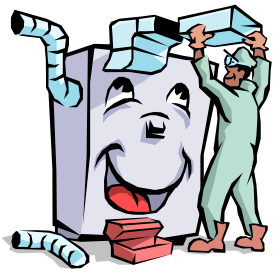
ISQC 1 – Introduction

- Personnel within the firm responsible for establishing and maintaining the firm's system of quality control shall have an understanding of the entire text of ISQC 1,
  - including its application and other explanatory material, to understand its objective and to apply its requirements properly (ISQC 1.13)



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ISQC 1 – Requirements

- Personnel within the firm responsible for establishing and maintaining the firm's system of quality control shall have an understanding of the entire text of ISQC 1,
  - including its application and other explanatory material, to understand its objective and to apply its requirements properly (ISQC 1.13)
- The firm shall comply with each requirement of ISQC 1
  - unless, in the circumstances of the firm, the requirement is not relevant to the services provided in respect of audits and reviews of financial statements, and other assurance and related services engagements (ISQC 1.14)

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ISQC 1 – Element of a System of QC

ISQC 1 requires:

- The firm shall establish and maintain a system of quality control that includes policies and procedures that address each of the following elements:

1. Leadership Responsibility
2. Relevant Ethical Requirements
3. Acceptance and Continuance
4. Human Resources
5. Engagement Performance
6. Monitoring

- Quality Manual
- Promote internal culture
- CEO or Managing partner(s) assume ultimate responsibility
- Integrity of the client
- Competent to perform the job
- Comply with ethical requirement
- Sufficient and competent personnel committed to ethics
- Each job with appropriate staff
- **Significant new requirements**

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ISQC 1 – Introduction

ISQC 1 requires:

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1. Leadership Responsibility
2. Relevant Ethical Requirements
3. Acceptance and Continuance
4. Human Resources
5. Engagement Performance
6. Monitoring

- The firm shall
  - **document** its policies and procedures and
  - **communicate** them to the firm's personnel (ISQC 1.17)

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ISQC 1 – Leadership

1. Leadership Responsibility

- The firm shall establish policies and procedures designed to promote an internal culture recognizing that quality is essential in performing engagements.
- Such policies and procedures shall require the firm's chief executive officer (or equivalent) or, if appropriate, the firm's managing board of partners (or equivalent),
  - to assume ultimate responsibility for the firm's system of quality control (ISQC 1.18)

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ISQC 1 – Leadership

- The promotion of a quality-oriented internal culture depends on clear, consistent and frequent actions and messages from all levels of the firm's management emphasizing the firm's quality control policies and procedures, and the requirement to:
  a) Perform work that complies with professional standards and appropriate legal and regulatory requirements; and
  b) Issue reports that are appropriate in the circumstances.
- Such actions and messages encourage a culture that recognizes and rewards high quality work.

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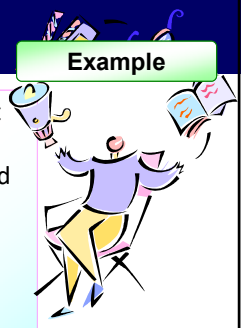
ISQC 1 – Leadership



Example

- These actions and messages (clear, consistent and frequent actions and messages from all levels of the firm's management) may be communicated by, but are not limited to,
  - training seminars,
  - meetings,
  - formal or informal dialogue,
  - mission statements,
  - newsletters, or
  - briefing memoranda.
- They may be incorporated in the firm's internal documentation and training materials, and in partner and staff appraisal procedures such that they will support and reinforce the firm's view on the importance of quality and how, practically, it is to be achieved.

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ISQC 1 – Leadership

- Of particular importance in promoting an internal culture based on quality is the need for the firm's leadership to recognize that the firm's business strategy is subject to the overriding requirement for the firm to achieve quality in all the engagements that the firm performs.
- Promoting such an internal culture includes:
  a) Establishment of policies and procedures that address performance evaluation, compensation, and promotion (including incentive systems) with regard to its personnel, in order to demonstrate the firm's overriding commitment to quality;
  b) Assignment of management responsibilities so that commercial considerations do not override the quality of work performed; and
  c) Provision of sufficient resources for the development, documentation and support of its quality control policies and procedures.

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ISQC 1 – Leadership

- The firm shall establish policies and procedures such that any person or persons assigned operational responsibility for the firm's system of quality control by the firm's chief executive officer or managing board of partners has
  - **sufficient and appropriate experience and ability**, and
  - the **necessary authority**, to assume that responsibility (ISQC 1.19)

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ISQC 1 – Leadership

- Sufficient and appropriate experience and ability
  - enables the responsible person or persons
    - to identify and understand quality control issues and
    - to develop appropriate policies and procedures.
- Necessary authority
  - enables the person or persons to implement those policies and procedures.

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ISQC 1 – Leadership

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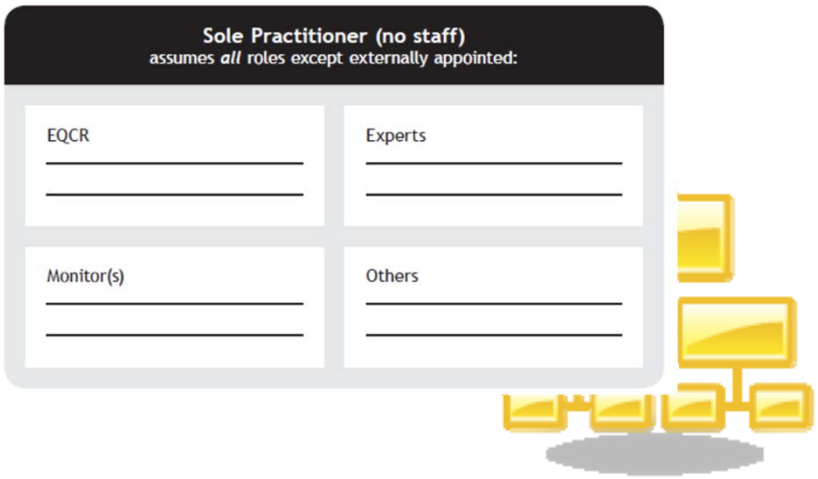
ISQC 1 – Leadership

- Firm's organisation chart – Sole practitioner with no staff



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Source: A Guide to Quality Control, HKICPA, 2013 27

ISQC 1 – Leadership

- Firm organisation chart – Sole practitioner with staff
- Firm organisation chart – Small to Medium Partnership

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Source: A Guide to Quality Control, HKICPA, 2013 28

ISQC 1 – Relevant Ethical Requirements

2. Relevant Ethical Requirements

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ISQC 1 – Relevant Ethical Requirements

- The firm shall establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements. (ISQC 1.20)

2. Relevant Ethical Requirements

What are relevant ethical requirements?

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ISQC 1 – Relevant Ethical Requirements

- The The IESBA Code (Code of Ethics issued by International Ethics Standards Board for Accountants) establishes the fundamental principles of professional ethics, which include:
  (a) Integrity;
  (b) Objectivity;
  (c) Professional competence and due care;
  (d) Confidentiality; and
  (e) Professional behavior.

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ISQC 1 – Relevant Ethical Requirements

- The firm shall establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and, where applicable, others subject to independence requirements (including network firm personnel), maintain independence where required by relevant ethical requirements.
- Such policies and procedures shall enable the firm to:
  a) Communicate its independence requirements to its personnel and, where applicable, others subject to them; and
  b) Identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action
     - to eliminate those threats or reduce them to an acceptable level by applying safeguards, or,
     - if considered appropriate, to withdraw from the engagement, where withdrawal is possible under applicable law or regulations (ISQC 1.21)

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ISQC 1 – Relevant Ethical Requirements

- Such policies and procedures shall require:
  a) Engagement partners to provide the firm with relevant information about client engagements, including the scope of services, to enable the firm to evaluate the overall impact, if any, on independence requirements;
  b) Personnel to promptly notify the firm of circumstances and relationships that create a threat to independence so that appropriate action can be taken; and
  c) The accumulation and communication of relevant information to appropriate personnel so that:
     i) The firm and its personnel can readily determine whether they satisfy independence requirements;
     ii) The firm can maintain and update its records relating to independence; and
     iii) The firm can take appropriate action regarding identified threats to independence. (ISQC 1.22)

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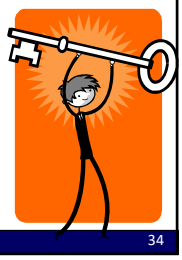
ISQC 1 – Relevant Ethical Requirements

- The firm shall establish policies and procedures designed
  – to provide it with reasonable assurance that it is notified of breaches of independence requirements, and
  – to enable it to take appropriate actions to resolve such situations. (ISQC 1.23)



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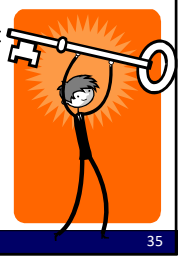
ISQC 1 – Relevant Ethical Requirements

- The policies and procedures shall include requirements for:
  a) Personnel to promptly notify the firm of independence breaches of which they become aware;
  b) The firm to promptly communicate identified breaches of these policies and procedures to:
     i) The engagement partner who, with the firm, needs to address the breach; and
     ii) Other relevant personnel in the firm and those subject to the independence requirements who need to take appropriate action; and
  c) Prompt communication to the firm, if necessary, by the engagement partner and the other individuals referred to in subparagraph (b)(ii) of the actions taken to resolve the matter, so that the firm can determine whether it should take further action. (ISQC 1.23)



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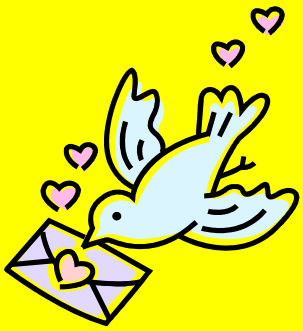
ISQC 1 – Relevant Ethical Requirements

- 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 the relevant ethical requirements. (ISQC 1.24)
  – Sample annual confirmation to be signed by staff from IAASB and HKICPA
  – Independent decision tree



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ISQC 1 – Relevant Ethical Requirements

- Familiarity threat that may be created by using the same senior personnel on an assurance engagement over a long period of time and the safeguards that might be appropriate to address such a threat.
- Accordingly, the firm shall establish policies and procedures:
  a) Setting out criteria for determining the need for safeguards to reduce the familiarity threat to an acceptable level when using the same senior personnel on an assurance engagement over a long period of time; and
  b) Requiring, for all audits of financial statements of listed entities, the rotation of the engagement partner and the individuals responsible for engagement quality control review, and whether applicable, other subjects to rotation requirements, after a specified period in compliance with the relevant ethical requirements (ISQC 1.25)

Safeguards?

- Rotation of senior staff
- Conduct EQC Review

Period?

- Not more 7 years

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ISQC 1 – Relevant Ethical Requirements

- Threats will fall into one or more of the following categories:
  a) **Self-interest** - the threat that a financial or other interest will inappropriately influence the professional accountant's judgment or behaviour;
  b) **Self-review** - the threat that a professional accountant will not appropriately evaluate the results of a previous judgment made or service performed by the professional accountant, or by another individual within the professional accountant's firm or employing organization, on which the accountant will rely when forming a judgment as part of providing a current service;
  c) **Advocacy** - the threat that a professional accountant will promote a client's or employer's position to the point that the professional accountant's objectivity is compromised;
  d) **Familiarity** - the threat that due to a long or close relationship with a client or employer, a professional accountant will be too sympathetic to their interests or too accepting of their work; and
  e) **Intimidation** - the threat that a professional accountant will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the professional accountant.

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ISQC 1 – Relevant Ethical Requirements

Example

Threat	Example	Possible Safeguards
Self-interest	An audit client who takes advantage of the fact that they are the largest client of the Firm and the loss of fees would be significant.	Firm-wide policy requires the appointment of an Engagement Quality Control reviewer on such engagements.
Self-review	A proposed member on the engagement team has recently worked for the assurance client and is in a position to exert direct and significant influence.	Firm-wide policies to: • Identify such conflicts during the hiring process; and • Ensure staff who have a conflict are not assigned to the engagement team.
Advocacy	The client asks the practitioner to attend a meeting with bankers to support their request for additional financing and answer some questions.	Firm-wide policy states that senior personnel may attend meetings between clients and bankers, but solely for the purpose of responding to information about assurance services provided.
Familiarity	The Firm or a person on the engagement team becomes too sympathetic to the client's interests.	Firm-wide policy prohibits staff or partners who have friends or family at the client from being on the engagement team.
Intimidation	The client has hinted that the Firm could be replaced if the practitioner continues to disagree with the application of a certain accounting principle.	The audit committee (or equivalent) should be fully informed and the Firm should consider third party consultations on the subject matter.

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Source: A Guide to Quality Control, HKICPA, 2013

Photo taken by Stephanie and Nelson © 2016

ISQC 1 – Accept and Continue

3. Acceptance and Continuance

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ISQC 1 – Accept and Continue

- The firm shall establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide the firm with reasonable assurance that it will only undertake or continue relationships and engagements where the firm:
  a) Is competent to perform the engagement and has the capabilities, including time and resources, to do so; and
  b) Can comply with relevant ethical requirements; and
  c) Has considered the integrity of the client, and does not have information that would lead it to conclude that the client lacks integrity.
  (ISQC 1.26)

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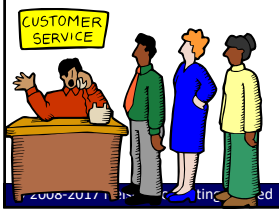
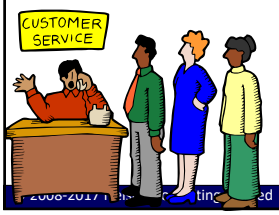
ISQC 1 – Accept and Continue

- Such policies and procedures shall require:
  - The firm to obtain such information as it considers necessary in the circumstances
    - before accepting an engagement with a new client,
    - when deciding whether to continue an existing engagement, and
    - when considering acceptance of a new engagement with an existing client. (ISQC 1.27)



ISQC 1 – Accept and Continue

  - If a potential conflict of interest is identified in accepting an engagement from a new or an existing client,
    - the firm to determine whether it is appropriate to accept the engagement
  - If issues have been identified, and the firm decides to accept or continue the client relationship or a specific engagement,
    - the firm to document how the issues were resolved. (ISQC 1.27)



ISQC 1 – Accept and Continue

Example

- List matters that the firm can consider with regard to the capabilities, competence, time and resources to undertake an engagement.

  - Firm personnel have knowledge of relevant industries or subject matters;
  - Firm personnel have experience with relevant regulatory or reporting requirements, or the ability to gain the necessary skills and knowledge effectively;
  - The firm has sufficient personnel with the necessary capabilities and competence;
  - Experts are available, if needed;
  - Individuals meeting the criteria and eligibility requirements to perform engagement quality control review are available, where applicable; and
  - The firm is able to complete the engagement within the reporting deadline.

ISQC 1 – Accept and Continue

Example

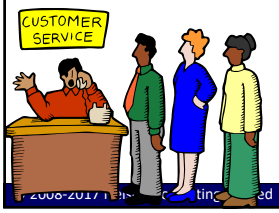
- List matters that the firm can consider with regard to the integrity of a client.

  - The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance.
  - 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 an inappropriate 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

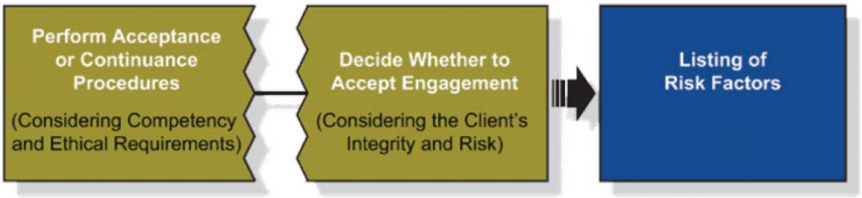
ISQC 1 – Accept and Continue

Continuance of Client Relationship

- Deciding whether to continue a client relationship includes consideration of
  - significant matters that have arisen during the current or previous engagements, and
  - their implications for continuing the relationship.
    - For example, a client may have started to expand its business operations into an area where the firm does not possess the necessary expertise

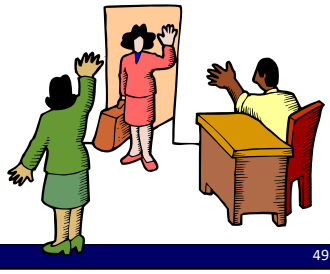


ISQC 1 – Accept and Continue



ISQC 1 – Accept and Continue

- The firm shall establish policies and procedures on continuing an engagement and the client relationship, addressing the circumstances where the firm obtains information that would have caused it to decline an engagement if that information had been available earlier.
- Such policies and procedures shall include consideration of:
  a) The professional and legal responsibilities that apply to the circumstances, including whether there is a requirement for the firm to report to the person or persons who made the appointment or, in some cases, to regulatory authorities; and
  b) The possibility of withdrawing
     - from the engagement or
     - from both the engagement and the client relationship. (ISQC 1.28)



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ISQC 1 – Accept and Continue

Withdrawal

- Policies and procedures on withdrawal from an engagement or from both the engagement and the client relationship address issues that include the following:
  - Discussing with the appropriate level of the client's management and those charged with its governance regarding the appropriate action that the firm might take based on the relevant facts and circumstances.
  - If the firm determines that it is appropriate to withdraw, discussing with the appropriate level of the client's management and those charged with its governance withdrawal from the engagement or from both the engagement and the client relationship, and the reasons for the withdrawal.
  - Considering whether there is a professional, regulatory or legal requirement for the firm to remain in place, or 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.
  - Documenting significant issues, consultations, conclusions and the basis for the conclusions.

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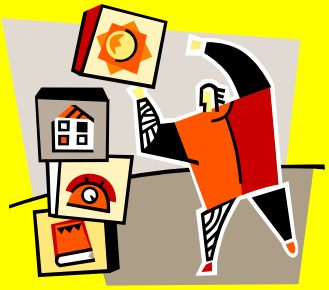
ISQC 1 – Accept and Continue

- Client Acceptance (suggested matters to consider)



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Source: Guide to Quality Control for SME Practices, Third Edition, 2011 51

ISQC 1 – Accept and Continue

- Assurance Engagement Acceptance Form
- Assurance Engagement Continuance Form
- Engagement Acceptance/Continuance Risk Tolerance Worksheet

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Source: A Guide to Quality Control, HKICPA, 2013 52

ISQC 1 – Human Resources

4. Human Resources

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ISQC 1 – Human Resources

- The firm shall establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary to
  - perform its engagements in accordance with professional standards and applicable legal and regulatory requirements, and
  - to enable the firm or engagement partners to issue reports that are appropriate in the circumstances. (ISQC 1.29)

4. Human Resources

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ISQC 1 – Human Resources

Example

- Personnel issues relevant to the firm's policies and procedures related to human resources include, for example:
  - Recruitment
  - Performance evaluation
  - Capabilities, including time to perform assignments
  - Competence
  - Career development
  - Promotion
  - Compensation
  - The estimation of personnel needs

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ISQC 1 – Human Resources

Example

- Capabilities and competence are developed through a variety of methods, including the following:
  - Professional education.
  - Continuing professional development, including training.
  - Work experience.
  - Coaching by more experienced staff, for example, other members of the engagement team.
  - Independence education for personnel who are required to be independent.

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ISQC 1 – Human Resources

- The continuing competence of the firm's personnel depends to a significant extent on an appropriate level of continuing professional development so that personnel maintain their knowledge and capabilities.
- Effective policies and procedures
  - emphasize the need for continuing training for all levels of firm personnel, and
  - provide the necessary training resources and assistance to enable personnel to develop and maintain the required competence and capabilities.
- Where internal technical and training resources are unavailable, or for any other reason,
  - the firm may use a suitably qualified external person for that purpose.

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ISQC 1 – Human Resources

- The firm's performance evaluation, compensation and promotion procedures give due recognition and reward to the development and maintenance of competence and commitment to ethical principles.
- In particular, the firm:
  a) Makes personnel aware of the firm's expectations regarding performance and ethical principles;
  b) Provides personnel with evaluation of, and counseling on, performance, progress and career development; and
  c) Helps personnel understand
     - that advancement to positions of greater responsibility depends, among other things, upon performance quality and adherence to ethical principles, and
     - that failure to comply with the firm's policies and procedures may result in disciplinary action.

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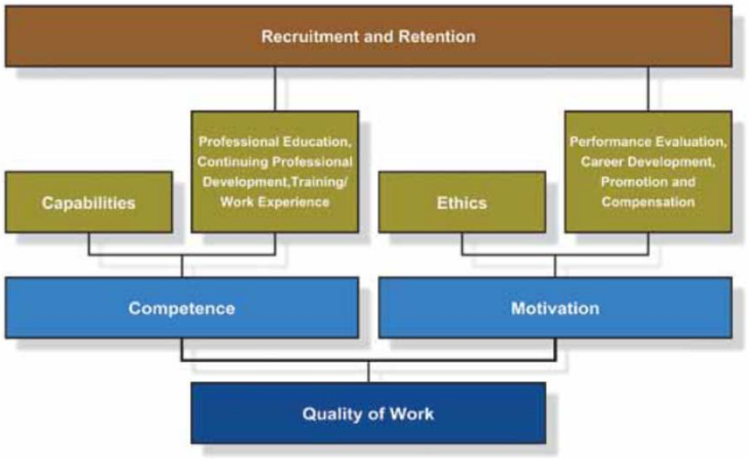
ISQC 1 – Human Resources



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Source: Guide to Quality Control for SME Practices, Third Edition, 2011

ISQC 1 – Human Resources

Example

- Performance appraisal – Annual self-assessment and plan
- Performance appraisal – Annual
- Performance appraisal – Specific engagement

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Source: A Guide to Quality Control, HKICPA, 2013

ISQC 1 – Human Resources

Assignment of Engagement Teams

- The firm shall assign responsibility for each engagement to an engagement partner.
- The firm shall establish policies and procedures requiring that:
  a) The identity and role of the engagement partner are communicated to key members of client management and those charged with governance;
  b) The engagement partner has the appropriate capabilities, competence, authority and time to perform the role; and
  c) The responsibilities of the engagement partner are clearly defined and communicated to that partner. (ISQC 1.30)

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ISQC 1 – Human Resources

- The firm shall also assign appropriate staff with the necessary capabilities, competence and time to
  - perform engagements in accordance with professional standards and applicable legal and regulatory requirements, and
  - enable the firm or engagement partners to issue reports that are appropriate in the circumstances. (ISQC 1.31)

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ISQC 1 – Human Resources

- Assignment of Personnel to Engagements
  – Suggested Planning Steps

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Source: Guide to Quality Control for SME Practices, Third Edition, 2011

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ISQC 1 – Engagement Performance

5. Engagement Performance

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ISQC 1 – Engagement Performance

- The firm shall establish policies and procedures designed to provide it with reasonable assurance
  - that engagements are performed in accordance with professional standards and applicable legal and regulatory requirements, and
  - that the firm or the engagement partner issue reports that are appropriate in the circumstances.
- Such policies and procedures shall include:
  a) Matters relevant to **promoting consistency in the quality** of engagement performance;
  b) **Supervision responsibilities**; and
  c) **Review responsibilities**. (ISQC 1.32)

5. Engagement Performance

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ISQC 1 – Engagement Performance

Consistency in the Quality of Engagement Perfomance

- Through its policies and procedures, the firm promotes consistency in the quality of engagement performance.
- This is often accomplished through written or electronic manuals, software tools or other forms of standardized documentation, and industry or subject matter-specific guidance materials.
- Matters addressed include the following:
  - How engagement teams are briefed on the engagement to obtain an understanding of the objectives of their work.
  - Processes for complying with applicable engagement standards.
  - Processes of engagement supervision, staff training and coaching.
  - Methods of reviewing the work performed, the significant judgments made and the form of report being issued.
  - Appropriate documentation of the work performed and of the timing and extent of the review.
  - Processes to keep all policies and procedures current.

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ISQC 1 – Engagement Performance

- **Supervision** includes the following:
  - Tracking the progress of the engagement.
  - Considering the capabilities and competence of individual members of the engagement team,
    - whether they have sufficient time to carry out their work,
    - whether they understand their instructions and
    - whether the work is being carried out in accordance with the planned approach to the engagement.
  - Addressing significant issues arising during the engagement, considering their significance and modifying the planned approach appropriately.
  - Identifying matters for consultation or consideration by more experienced engagement team members during the engagement.

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ISQC 1 – Engagement Performance

Review responsibilities

- The firm's review responsibilities shall be determined on the basis that more experienced engagement team members is reviewed by more experienced team members.
- A review consists of consideration of whether:
  a) The work has been performed in accordance with professional standards and regulatory and legal requirements;
  b) Significant matters have been raised for further consideration;
  c) Appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
  d) There is a need to revise the nature, timing and extent of work performed;
  e) The work performed supports the conclusions reached and is appropriately documented;
  f) The evidence obtained is sufficient and appropriate to support the report; and
  g) The objectives of the engagement procedures have been achieved.

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ISQC 1 – Engagement Performance

- The firm's policies and procedures on engagement performance should include:

Consultation

Differences of opinion

Engagement Quality Control Review

Documentation

- Consultation policies and procedures should be established and designed to provide it with reasonable assurance that:
  a) Appropriate consultation takes place on **difficult or contentious matters**;
  b) Sufficient resources are available to enable appropriate consultation to take place;
  c) The nature and scope of, and consultations resulting from, are documented and are agreed by both parties; and
  d) Conclusions resulting from consultations are implemented. (ISQC 1.34)

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ISQC 1 – Engagement Performance

Consultation

- Consultation includes discussion, at the appropriate professional level, with individuals within or outside the firm who have specialized expertise, to resolve a difficult or contentious matter.

- It uses appropriate research resources as well as the collective experience and technical expertise of the firm
- It helps to promote quality and improves the application of professional judgment
- Appropriate recognition of consultation in the firm's policies and procedures helps to promote a culture in which consultation is recognized as a strength and encourages personnel to consult on difficult or contentious matters

Effective consultation 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, and when conclusions resulting from consultations are appropriately documented and implemented.

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ISQC 1 – Engagement Performance

Example

Consultation

- What kinds of issues should be subject to consultation?
- What kinds of appropriate consultation are available?
- Can a firm use the resources of professional accounting bodies, such as ACCA, ICAEW, and HKICPA for their consultation?
- Sample documents enclosed include:
  - Consultation checklist
  - Consultation engagement letter
  - Consultation or Specialist Risk Tolerance Worksheet

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ISQC 1 – Engagement Performance

Consultation

- The documentation of consultations with other professionals that involve **difficult or contentious matters** is agreed by both the individual seeking consultation and the individual consulted.
- The documentation is sufficiently complete and detailed to enable an understanding of:
  a) The issue on which consultation was sought; and
  b) The results of the consultation, including any decisions taken, the basis for those decisions and how they were implemented.

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ISQC 1 – Engagement Performance

Consultation

- A firm needing to consult externally, for example, a firm without appropriate internal resources, may take advantage of advisory services provided by:
  – Other firms;
  – Professional and regulatory bodies; or
  – Commercial organizations that provide relevant quality control services.
- Before contracting for such services, consideration of the competence and capabilities of the external provider helps the firm to determine whether the external provider is suitably qualified for that purpose.

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ISQC 1 – Engagement Performance

Differences of opinion

- The firm shall establish policies and procedures for dealing with and resolving differences of opinion
  - within the engagement team,
  - with those consulted and,
  - where applicable, between the engagement partner and the engagement quality control reviewer. (ISQC 1.43)
- Such policies and procedures shall require that:
  - Conclusions reached be documented and implemented; and
  - The report not be dated until the matter is resolved. (ISQC 1.44)

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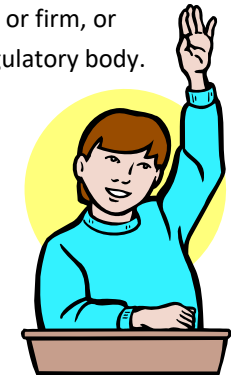
ISQC 1 – Engagement Performance

Example

Differences of opinion

- How does a firm resolve differences in opinion?
  - Procedures to resolve such differences may include consulting with
    - another practitioner or firm, or
    - a professional or regulatory body.



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ISQC 1 – Engagement Performance

- The firm shall establish policies and procedures requiring, for appropriate engagements, an **engagement quality control review** (**EQC Review**) that provides an objective evaluation of
  - the significant judgments made by the engagement team and
  - the conclusions reached in formulating the report. (ISQC 1.35)

Engagement Quality Control Review

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ISQC 1 – Engagement Performance

Engagement Quality Control Review

- Such policies and procedures shall:
  a) Require an EQC Review for all audits of financial statements of listed entities;
  b) Set out criteria against which all other audits and reviews of historical financial information, and other assurance and related services engagements shall be evaluated to determine whether an EQC Review should be performed; and
  c) Require an EQC Review for all engagements, if any, meeting the criteria established in compliance with subparagraph (b) above. (ISQC 1.35)

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ISQC 1 – Engagement Performance

Example

- Criteria for determining which engagements, other than audits of financial statements of listed entities, are to be subject to an engagement quality control review may include, for example:
  - The nature of the engagement, including the extent to which it involves a matter of public interest.
  - The identification of unusual circumstances or risks in an engagement or class of engagements.
  - Whether laws or regulations require an engagement quality control review.

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ISQC 1 – Engagement Performance

Nature, Timing and Extent of the EQC Review

- The firm shall establish policies and procedures setting out the nature, timing and extent of an EQC Review
- Such policies and procedures shall require that the engagement report not be dated until the completion of the EQC Review. (ISQC 1.36)

Engagement Quality Control Review

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ISQC 1 – Engagement Performance

Nature, Timing and Extent of the EQC Review

- The engagement report is not dated until the completion of the EQC Review; but documentation of the EQC Review may be completed after the date of the report.
- Conducting the EQC Review in a timely manner at appropriate stages during the engagement allows significant matters to be promptly resolved to the EQC reviewer's satisfaction on or before the date of the report.

Engagement Quality Control Review

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ISQC 1 – Engagement Performance

Nature, Timing and Extent of the EQC Review

- The firm shall establish policies and procedures to require the EQC Review to include:
  a) discussion with the engagement partner;
  b) review of the financial statements or other subject matter information and the report;

Engagement Quality Control Review

  c) Review of selected engagement documentation relating to significant judgments the engagement team made and the conclusions it reached; and
  d) Evaluation of the conclusions reached in formulating the report and consideration of whether the proposed report is appropriate.

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ISQC 1 – Engagement Performance

Nature, Timing and Extent of the EQC Review

- For audits of financial statements of listed entities, the firm shall establish policies and procedures to require the EQC Review to also include consideration of the following:
  a) The engagement team's evaluation of the firm's independence in relation to the specific engagement;
  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
  c) Whether documentation selected for review reflects the work performed in relation to the significant judgments and supports the conclusions reached.

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ISQC 1 – Engagement Performance

Example

Nature, Timing and Extent of the EQC Review

- Other matters relevant to evaluating the significant judgments made by the engagement team that may be considered in an engagement quality control review of an audit of financial statements of a listed entity include:
  - Significant risks identified during the engagement and the responses to those risks.
  - Judgments made, particularly with respect to materiality and significant risks.
  - The significance and disposition of corrected and uncorrected misstatements identified during the engagement.
  - The matters to be communicated to management and those charged with governance and, where applicable, other parties such as regulatory bodies.

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ISQC 1 – Engagement Performance

Criteria for the Eligibility of EQC Reviewers

- The firm shall establish policies and procedures to address the appointment of EQC reviewers and establish their eligibility through:
  a) The technical qualifications required to perform the role, including the necessary experience and authority; and
  b) The degree to which an EQC reviewer can be consulted on the engagement without compromising the reviewer's objectivity. (ISQC 1.39)

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ISQC 1 – Engagement Performance

Criteria for the Eligibility of EQC Reviewers

- The firm shall establish policies and procedures to maintain the objectivity of the EQC Reviewer. (ISQC 1.40)
  - For example, the EQC Reviewer:
    a) Where practicable, is not selected by the engagement partner;
    b) Does not otherwise participate in the engagement during the period of review;
    c) Does not make decisions for the engagement team; and
    d) Is not subject to other considerations that would threaten the reviewer's objectivity.
- The firm's policies and procedures shall provide for the replacement of the EQC reviewer where the reviewer's ability to perform an objective review may be impaired. (ISQC 1.41)

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ISQC 1 – Engagement Performance

Criteria for the Eligibility of EQC Reviewers

- Consideration specific to smaller firms
  - Suitably qualified external persons may be contracted where sole practitioners or small firms identify engagements requiring engagement quality control reviews.
  - Alternatively, some sole practitioners or small firms may wish to use other firms to facilitate engagement quality control reviews.
  - Where the firm contracts suitably qualified external persons, the firm follows the described requirements and guidance.

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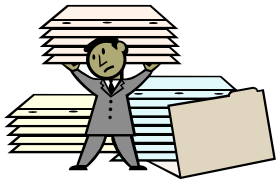
ISQC 1 – Engagement Performance

Documentation of EQC Review

- The firm shall establish policies and procedures on documentation of the EQC Review which require documentation that:
  a) The procedures required by the firm's policies on EQC review have been performed;
  b) The EQC review has been completed on or before the date of the report; and
  c) The reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions they reached were not appropriate. (ISQC 1.42)



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ISQC 1 – Engagement Performance

- Criteria for when a EQC Review is required
- EQC Review – Suggested Procedures
- EQC Review Worksheet

Engagement Quality Control Review

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ISQC 1 – Engagement Performance

Completion of the Assembly of Final Engagement Files

- The firm shall establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports have been finalized. (ISQC 1. 45)

Documentation

- Observe local laws and regulations
- If no such laws or regulations, **not be more than 60 days** (60-day rule) after the date of auditor's report
- If there are more than one report for ame subject, address each report as if it were for a separate engagement

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ISQC 1 – Engagement Performance

Confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation

- The firm shall establish policies and procedures designed to maintain
  - the confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation. (ISQC 1. 46)

Documentation

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ISQC 1 – Engagement Performance

Retention of engagement documentation

- The firm shall establish policies and procedures for the retention of engagement documentation for a period sufficient to meet the needs of the firm or as required by law or regulation. (ISQC 1.47)

Documentation

- Observe local laws and regulations
- The retention period ordinarily is **no shorter than 5 years** from the date of the auditor's report, or, if later, the date of the group auditor's report

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ISQC 1 – Monitoring

6. Monitoring

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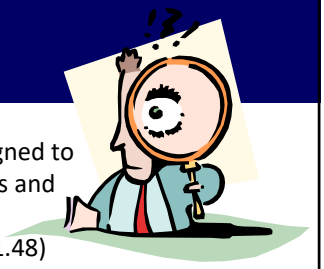
ISQC 1 – Monitoring



- The firm shall establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively. (ISQC 1.48)
  - Such requirements are collectively referred as **monitoring**

ISQC 1 defines:

- **Monitoring** – A process comprising an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements, designed to provide the firm with reasonable assurance that its system of quality control is operating effectively.

6. Monitoring

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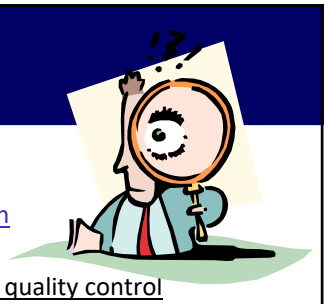
ISQC 1 – Monitoring



- This process shall:
  a) Include an ongoing consideration and evaluation of the firm's system of quality control including,
     - on a cyclical basis, inspection (or termed as quality control review) of at least one completed engagement for each engagement partner;
  b) Require responsibility for the monitoring process to be assigned to a partner or partners or other persons with sufficient and appropriate experience and authority in the firm to assume that responsibility; and
  c) Require that those performing the engagement or the EQC review are not involved in inspecting the engagement. (ISQC 1.48)

Ongoing Evaluation

Cyclical Inspection of Completed Files

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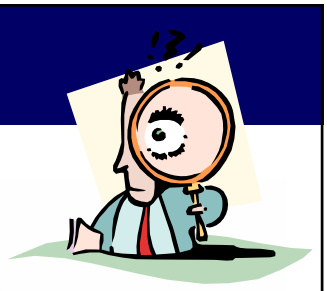
ISQC 1 – Monitoring



Monitoring Pyramid

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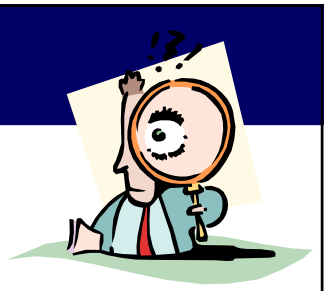
ISQC 1 – Monitoring



- The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of:
  a) Adherence to professional standards and applicable legal and regulatory requirements;
  b) Whether the quality control system has been appropriately designed and effectively implemented; and
  c) Whether the firm's quality control policies and procedures have been appropriately applied, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances.

Ongoing Evaluation

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ISQC 1 – Monitoring

Example

- Ongoing consideration and evaluation of the system of quality control include matters such as the following:
  - Analysis of:
    - New developments in professional standards and applicable legal and regulatory requirements, and how they are reflected in the firm's policies and procedures where appropriate;
    - Written confirmation of compliance with policies and procedures on independence;
    - Continuing professional development, including training; and
    - Decisions related to acceptance and continuance of client relationships and specific engagements.

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ISQC 1 – Monitoring

Example

- Ongoing consideration and evaluation of the system of quality control include matters such as the following:
  - Determination of corrective actions to be taken and improvements to be made in the system, including the provision of feedback into the firm's policies and procedures relating to education and training.
  - Communication to appropriate firm personnel of weaknesses identified in the system, in the level of understanding of the system, or compliance with it.
  - Follow-up by appropriate firm personnel so that necessary modifications are promptly made to the quality control policies and procedures.

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ISQC 1 – Monitoring

- Inspection cycle policies and procedures may, for example, specify a cycle that spans **three years**.
- The manner in which the inspection cycle is organized, including the timing of selection of individual engagements, depends on many factors, such as the following:
  - The size of the firm.
  - The number and geographic location of offices.
  - The results of previous monitoring procedures.
  - The degree of authority both personnel and offices have (for example, whether individual offices are authorized to conduct their own inspections or whether only the head office may conduct them).
  - The nature and complexity of the firm's practice and organization.
  - The risks associated with the firm's clients and specific engagements.

Cyclical Inspection of Completed Files

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ISQC 1 – Monitoring

- In determining the scope of the inspections, the firm may take into account the scope or conclusions of an independent external inspection program.
  - However, an independent external inspection program does not act as a substitute for the firm's own internal monitoring program.
- Small firms and sole practitioners may wish to use a suitably qualified external person or another firm to carry out engagement inspections and other monitoring procedures.
- Alternatively, they may wish to establish arrangements to share resources with other appropriate organizations to facilitate monitoring activities.

Cyclical Inspection of Completed Files

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ISQC 1 – Monitoring

Example

- What can be performed in QAR?

Cyclical Inspection of Completed Files

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ISQC 1 – Monitoring

- The firm shall evaluate the effect of deficiencies noted as a result of the monitoring process and determine whether they are either:
  a) Instances that do not necessarily indicate that the firm's system of quality control is insufficient to provide it with reasonable assurance that it complies with professional standards and applicable legal and regulatory requirements, and that the reports issued by the firm or engagement partners are appropriate in the circumstances; or
  b) Systemic, repetitive or other significant deficiencies that require prompt corrective action. (ISQC 1.49)

Ongoing Evaluation

Cyclical Inspection of Completed Files

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ISQC 1 – Monitoring

- The firm shall communicate to relevant engagement partners and other appropriate personnel deficiencies noted as a result of the monitoring process and recommendations for appropriate remedial action. (ISQC 1.50)

Ongoing Evaluation

Cyclical Inspection of Completed Files

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ISQC 1 – Monitoring

Example

- What are the recommendations for each type of deficiency?

- Recommendations for appropriate remedial actions for deficiencies noted shall include one or more of the following:
  a) Taking appropriate remedial action in relation to an individual engagement or member of personnel;
  b) The communication of the findings to those responsible for training and professional development;
  c) Changes to the quality control policies and procedures; and
  d) Disciplinary action against those who fail to comply with the policies and procedures of the firm, especially those who do so repeatedly. (ISQC 1.51)

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ISQC 1 – Monitoring

- Where the results of the monitoring procedures indicate
  - that a report may be inappropriate or
  - that procedures were omitted during the performance of the engagement,
    - Such policies and procedures shall require the firm to determine what further action is appropriate to comply with relevant professional standards and applicable legal and regulatory requirements.
- It shall also consider obtaining legal advice. (ISQC 1.52)

Ongoing Evaluation

Cyclical Inspection of Completed Files

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ISQC 1 – Monitoring

- At least annually, the firm shall communicate the results of the monitoring of its quality control system to engagement partners and other appropriate individuals within the firm, including the firm's CEO or, if appropriate, its managing board of partners.
- Such communication shall be sufficient to enable the firm and these individuals to take prompt and appropriate action where necessary in accordance with their defined roles and responsibilities.
- Information communicated shall include the following:
  a) A description of the monitoring procedures performed.
  b) The conclusions drawn from the monitoring procedures.
  c) Where relevant, a description of systemic, repetitive or other significant deficiencies and of the actions taken to resolve or amend those deficiencies. (ISQC 1.53)

Ongoing Evaluation

Cyclical Inspection of Completed Files

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ISQC 1 – Monitoring

- Some firms operate as part of a network and, for consistency, may implement some or all of their monitoring procedures on a network basis.
- Where firms within a network operate under common monitoring policies and procedures designed to comply with this ISQC, and these firms place reliance on such a monitoring system, the firm's policies and procedures shall require that
  a) At least annually, the network communicates the overall scope, extent and results of the monitoring process to appropriate individuals within the network firms; and
  b) The network communicates promptly any identified deficiencies in the quality control system to appropriate individuals within the relevant network firm or firms so that the necessary action can be taken; and

  In order that engagement partners in the network firms can rely on the results of the monitoring process implemented within the network, unless the firms or the network advises otherwise.

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ISQC 1 – Monitoring

- Appropriate documentation relating to monitoring includes, for example:
  a) Monitoring procedures, including the procedure for selecting completed engagements to be inspected;
  b) A record of the evaluation of:
     i) Adherence to professional standards and applicable legal and regulatory requirements;
     ii) Whether the quality control system has been appropriately designed and effectively implemented; and
     iii) Whether the firm's quality control policies and procedures have been appropriately applied, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances; and
  c) Identification of the deficiencies noted, an evaluatation of their effect, and the basis for determining whether and what further action is necessary.

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ISQC 1 – Monitoring

Complaints and Allegations

- The firm shall establish policies and procedures designed to provide it with reasonable assurance that it deals appropriately with:
  a) Complaints and allegations that the work performed by the firm fails to comply with professional standards and applicable legal and regulatory requirements; and
  b) Allegations of non-compliance with the firm's system of quality control.
- As part of this process, the firm shall establish clearly defined channels for firm personnel to raise any concerns in a manner that enables them to come forward without fear of reprisals. (ISQC 1.55)

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ISQC 1 – Documentation

- The firm shall establish policies and procedures requiring
  - appropriate documentation to provide evidence of the operation of each element of its system of quality control. (ISQC 1.57)
  - retention of documentation for a period of time sufficient to permit those performing monitoring procedures to evaluate the firm's compliance with its system of quality control, or for a longer period if required by law or regulation. (ISQC 1.58)
  - documentation of complaints and allegations and the responses to them. (ISQC 1.59)

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ISQC 1 – Documentation

- The form and content of documentation evidencing the operation of each of the elements of the system of quality control is a matter of judgment and depends on a number of factors, including the following:
  - The size of the firm and the number of offices.
  - The nature and complexity of the firm's practice and organization.

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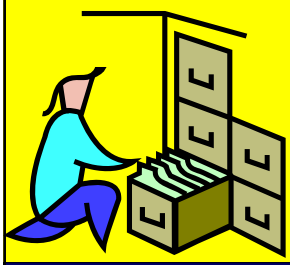
ISQC 1 – Documentation

- How such matters are documented is the firm's decision.
  - For example,
    - Large firms may use electronic databases to document matters such as independence confirmations, performance evaluations and the results of monitoring inspections
    - Smaller firms may use more informal methods such as manual notes, checklists and forms.



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Today's Agenda

ISA 220 (Quality Control for a Job)

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Overview

ISQCs International Standards on Quality Control
(only ISQC 1 issued so far)

International Framework for Assurance Engagements

Audits and Reviews of Historical Financial Information

International Standards on Auditing (ISAs) → Practice Notes and Auditing Guideline

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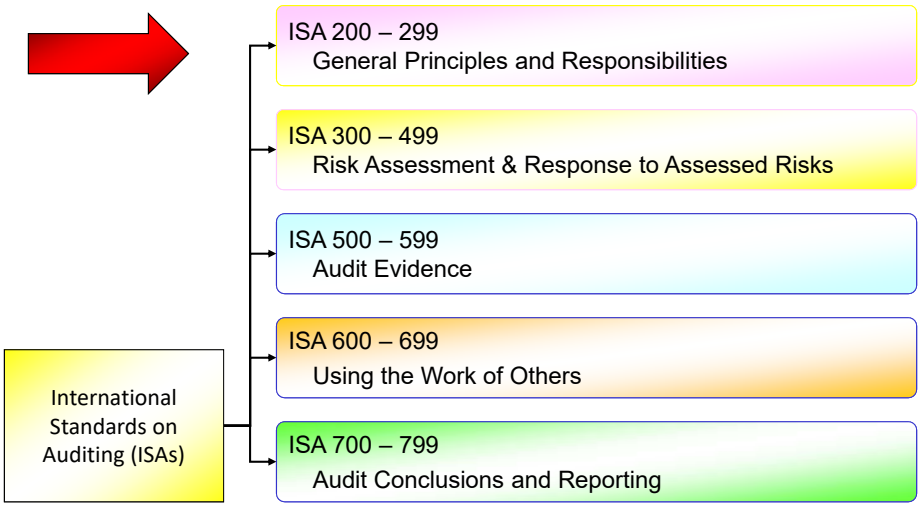
ISQC and ISAs



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General Principles and Responsibilities

ISA 200 – 299
General Principles and Responsibilities

ISA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing
ISA 210 Agreeing the Terms of Audit Engagements
ISA 220 Quality Control for an Audit of Financial Statements
ISA 230 Audit Documentation
ISA 240 The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements
ISA 250 Consideration of Laws and Regulations in an Audit of Financial Statements
ISA 260 Communication with Those Charged with Governance
ISA 265 Communicating Deficiencies in Internal Control to Those Charged with Governance and Management

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General Principles and Responsibilities

- Generally, ISAs 200 – 265 set out the general principles and responsibilities for a particular engagement on an audit of financial statements
- In particular, ISA 220 sets out the quality control on a particular audit engagement
  - Similar to those set out in ISQC 1
  - While ISA 220 is tailored to an engagement on an audit of financial statemtents

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ISA 220

- Certain responsibilities must be taken by the engagement partner, including
  - Overall quality of the engagement (ISA 220.8)
  - Comply with relevant ethical requirements (ISA 220.9)
  - Conclude on compliance with independence requirements that apply to the audit engagement (ISA 220.11)
  - Satisfy appropriate procedures regarding the acceptance and continuance of client relationships followed (ISA 220.12)
  - Satisfy the engagement team collectively having appropriate capabilities, competence and time to perform the engagement and enable an auditor's report that is appropriate in the circumstances to be issued (ISA 220.14)
  - Take responsibility for the direction, supervision and performance of the audit engagement (ISA 220.15)
  - Be responsible for the engagement team undertaking appropriate consultation on difficult or contentious matters (ISA 220.18)

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ISA 220

- Certain responsibilities must be taken by the engagement partner, including

1. Leadership Responsibility
2. Relevant Ethical Requirements
3. Acceptance and Continuance
4. Human Resources
   - Assignment of Engagement Teams
5. Engagement Performance
6. Monitoring

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Overview

ISQCs International Standards on Quality Control
(only ISQC 1 issued so far)

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Audits and Reviews of Historical Financial Information

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Tips for Cost-Effective ISQC 1 Application

Tip 1: Take Time to Study the Standard and Review Available Supporting Implementation Guidance

Tip 2: Compare Current QC System with ISQC 1

Tip 3: Tailor the QC Policies and Procedures

Tip 4: Assess the Need for Outside Help

Tip 5: Education and Training

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Source: Tips for Cost-Effective ISQC 1 Application, 2011

Workshop on ISQC 1 and ISA 220

(as per IAASB's ISQC and ISA Handbook 2012) 18 February 2017

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