

Annual review of APES 320 Quality Control for Firms issued in May 2006

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1. Executive Summary

1.1. Background

Accounting Professional and Ethical Standards Board (APESB) issued *APES 320 Quality Control for Firms* in May 2006 with an effective date of 01 July 2006.

1.2. Reason for this report

In accordance with the constitution of APESB, an annual review needs to be performed twelve months after an issue of a new standard. This report presents a review of the issues identified and a proposed course of action to address the identified issues.

1.3. Issues identified

The issues identified since the issue of the standard in May 2006 are summarised below:

Issues arising subsequent to the 6 Month Review:

1. IAASB have issued exposure drafts in July 2007 for comments by December 31 2007 on *ISA 220 Quality Control for an Audit of Financial Statements* and *ISQC 1 Quality Control for Firms that Perform Audits & Reviews of Financial Statements and Other Assurance Related Services Engagements*. The subsequent issue of these standards will have an impact on APES 320.
2. Definition of “assurance engagement” needs to be updated, as the AUASB has replaced AUS 108 in July 2007.
3. The definition of the term “firm” in APES 320 is not consistent with the definition in APES 110 as it excludes the Auditor General’s Office or department. Also there is an implication in the definition that all four components of the definition must be met through the use of the word “and”.
4. The definition of “Network Firm” in APES 320 will need to be updated in line with the proposed amendments to the Network Firm definition in APES 110. Also the use of the term “Network” is introduced by virtue of its inclusion in the Network Firm definition and this need to be defined in APES 320.
5. The definition of “Professional Standards” in APES 320 needs to be updated to reflect the generic use of the term of professional bodies and to remove references to the specific professional body.

Carry forward Issues from 6 Month Review:

6. Formatting of paragraph 56 of the standard: *Documentation of consultations with other professionals*.
7. Paragraph 73 (e) “a legal or professional duty to disclose”. Under Australian Law there is only a legal duty to disclose.

1.4. Summary of Recommendations

The following is a list of the recommendations contained in the main report. It is recommended that:

Issues arising subsequent to the 6 Month Review:

1. APESB monitor the development of the International Exposure Draft *ISQC 1: Quality Control for Firms that perform Audits and Reviews of Financial Statements and Other Assurance Related Service Engagements* and consider the impact on APES 320 with a view to incorporating any amendments as required.
2. Update the definition of “assurance engagement” to refer to the Assurance Framework issued by the AUASB which has replaced AUS 108 in the next revision to the Standard.
3. Update the definition of “firm” to include an Auditor-General’s office or department which is consistent with the definition of “firm” in APES 110 Code of Ethics for Professional Accountants and replace the word “and” with “or” so that the components are not all inclusive.
4. The definition of “Network Firms” needs to be updated in line with the proposed amendments to the Network Firm definition in APES 110. Also the use of the term “Network” is introduced by virtue of its inclusion in the Network Firm definition. It will also need to be defined in APES 320.
5. The definition of “Professional Standards” to be updated to remove the reference to the specific professional body and to use the generic term “professional bodies”.

Carry forward Issues from 6 Month Review:

6. Include additional text in the unboxed part of paragraph 56 to improve the clarity of the requirements that apply to assurance practices and other practices.
7. In the next version of the standard the wording “or professional” in paragraph 73 (e) should be deleted as there is only a legal duty to disclose.

2 Review of Implementation Issues

Issues arising subsequent to the 6 Month Review:

2.1 International Developments with Exposure Drafts issued in July 2007

Issue

The proposed International Standard on Auditing (ISA 220) has been redrafted in accordance with conventions agreed by the International Auditing and Assurance Standards Board (IAASB) to be applied to all ISAs. Those conventions, adapted as necessary, have also been applied in redrafting the proposed ISQC 1. The IAASB approved the proposed redrafted ISA and ISQC 1 for exposure in July 2007.

The IAASB decided to clarify extant ISQC 1, “Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements” at the same time as extant ISA 220, as together they deal with important quality control considerations at both the firm level and the engagement level. Further, in complying with extant ISA 220, the engagement team is entitled to rely on the firm’s policies and procedures established under extant ISQC 1. The standards are therefore closely linked, and the IAASB believes that their clarification at the same time makes sense to ensure consistency between them and in their application.

Significant matters raised in the IAASB ISQC 1 Exposure Draft are:

1. **The ISQC 1 ED documents the authority of the ISQC and the obligation of firms that follow it.**
2. **Date of Completion of Engagement Quality Control Review** – amended to tie in with ISA 700 by referring to the date of the audit report rather than the issuance of the audit report. This impacts the definition of “Engagement Quality Control Review” in APES 320 plus paragraphs 60 to 73 of the Standard. Reference to issuance of the audit report needs to be changed to the date of the audit report.
3. **Definition of Engagement team** – which is redrafted to reflect the IESBA proposed definition for engagement team included in S290 and S291 Independence. This impacts the definition of “engagement team” contained in APES 320 plus paragraphs 42 to 45. The IAASB definition is subject to further consideration by that body and the IESBA.

4. **ISQC 1** redrafted to show mandatory requirements (paragraphs 1-67), separately to the application of these mandatory requirements (paragraphs A1 to A69).

The new ISQC 1 mandatory section has an increased number of mandatory paragraphs, meaning there would be additional black letter paragraphs in a revised APES 320 based upon the ISQC1 ED. However the essential elements of a system of Quality Control remain the same.

The grey letter paragraphs of APES 320 which provide discussion or explanation of the black letter mandatory section have now been placed in the separate section of the new ISQC Exposure Draft.

Stakeholders

The Professional Bodies and Assurance and non assurance firms will be impacted by this Exposure Draft as the mandatory requirements in respect of audits and reviews of financial statements and other assurance and related services engagements have been expanded.

Recommendation

Monitor the development of the International Exposure Draft and consider the impact on APES 320 with a view to incorporating any amendments as required.

2.2 Update the definition of “Assurance Engagement” in APES 320

Issue

The definition of “Assurance Engagement” needs to be updated as the AUASB has replaced AUS 108 Framework for Assurance Engagements in July 2007. AUS 108 is referred to in the APES 320 definition of “Assurance Engagements”.

Stakeholders

Professional Accounting Bodies, Firms and Members will be impacted by this change in definition.

Recommendation

To ensure consistency with the AUASB definition, it is recommended the second paragraph of the definition of Assurance Engagement in APES 320 be updated as follows: “This would include an Engagement in accordance with the Framework for Assurance Engagements issued by the Auditing and Assurance Standards Board (AUASB) or in accordance with the specific relevant standards for Assurance Engagements.”

2.3 Consistency of definition of “firm” in APES 320

Issue

The definition of the term “firm” is not consistent with the APES 110 definition which includes the additional component of Auditor–General’s Office or Department.

In addition, part (c) and part (d) of the components to the definition of what a firm is are connected by the word “and”. This implies that all four components of the definition must be met to satisfy the definition. It is unlikely that any firm would therefore meet this definition.

Stakeholders

Professional Accounting Bodies, Firms and Members will be impacted by this change in definition.

Recommendation

It is recommended:

- The definition of “firm” be changed to reflect the additional component of Auditor-General’s department and
- the word “and” be replaced with “or” to read:

“(a) A sole practitioner, partnership, corporation or other entity of professional accountants;
(b) An entity that controls such parties;
(c) An entity controlled by such parties; or
(d) An Auditor – General’s office or department.”

2.4 Update the definition of “Network Firms”

Issue

APESB issued for exposure amendments to the network firm definition in APES 110. Dependent on the finalization of the exposure draft this definition would also require to be updated.

In addition the definition of “Network” is referred to in the “Network Firm” definition. Therefore it will need to be included amongst the definitions in APES 320 to specify what would be considered to be a network.

Stakeholders

Professional Accounting Bodies, Firms and Members will be impacted by this change in definition.

Recommendation

It is recommended:

- the definition of “Network Firms” be updated in line with the proposed amendments to APES 110.
- the definition of “Network” be included in the definitions in APES 320.

2.5 Update the definition of “Professional Standards”

Issue

The definition of “Professional Standards” in APES 320 refers to “all professional and ethical requirements of the Institute and CPA Australia and all standards issued by the Accounting and Ethical Standards Board” (APESB).

This definition should be amended to remove the reference to the specific professional body and use the generic term of “professional body”.

Stakeholders

Professional Accounting Bodies, Firms and Members will be impacted by this change in definition.

Recommendation

It is recommended the definition of “Professional Standards” be updated as follows:

“Professional Standards mean all standards issued by the Accounting & Ethical Standards Board and all professional and ethical requirements of the applicable professional body”.

Carried forward issues from the 6 month review

2.6 Formatting of Paragraph 56 : *Documentation of Consultations with other professionals*

Issue

Paragraph 56 of APES 320 discusses the requirement to document consultations that occurred with other professionals or experts in respect of difficult or contentious matters and the requirement for both parties to agree to the documentation. There is a box around the first part of the paragraph indicating its applicability to assurance practices only. This has caused confusion among some users regarding the application of the paragraph to assurance and other engagements.

Analysis of the issue

Paragraph 56 is in essence providing guidance to the black letter standard contained in paragraph 51, which states that firms shall establish policies and procedures in relation to consultations that take place in respect of difficult or contentious matters and the process for documenting these consultations.

The rationale to have the first part in a box was to mandate that in respect of assurance engagements the consultations on difficult or contentious matters need to be documented in a manner agreed to by the individual seeking the consultation and the individual consulted. Thus in respect of “non assurance” engagements it is not necessary for all parties to agree to the documentation as in some cases these will be of a general or informal nature.

The rest of the paragraph dealt with the fact that the documentation needs to be sufficiently complete and detailed to enable an understanding of the issue as well as the results of the consultation. The current view is that the unblocked portion of this is applicable to all practices (assurance and non assurance) as it is considered to supply guidance on the mandatory requirements of paragraph 51.

In other areas of the standard the paragraphs relating to assurance practices have been similarly blocked and the purpose of separating it has been explained in the application requirements of APES 320. The difference in paragraph 56 is that part of the paragraph is blocked as applicable to assurance practices whilst the other part is not.

Impacted Stakeholders

Firms will be impacted by this paragraph as they are required to keep documentation on consultations that takes place on difficult/contentious issues in respect of all engagements.

This issue was raised by the ACAG Financial Reporting and Auditing committee in their response to the Exposure Draft in May 2006.

Recommendation

In order to improve the clarity of paragraph 56, the unboxed part of paragraph 56 be amended to read as follows:

The documentation of consultations by the Firm in accordance with policies and procedures developed to comply with paragraph 51 (c) and (d) above, is sufficiently complete and detailed to enable an understanding of:

- (a) The issue on which consultation was sought;*
- (b) The results of the consultation, including any decisions taken, the basis for those decisions and how they were implemented.*

The bold text is additional wording recommended by the ICAA, which will make it clear that it relates to the documentation of consultations in respect of all engagements as per the standard stipulated in paragraph 51.

As there have not been significant member inquiries in this regard it is recommended that this amendment be done in the next revision of the standard.

2.7 Paragraph 73 (e) – “Legal or Professional duty to disclose”

Issue

Paragraph 73 (e) refers to the obligation of the firm’s personnel to observe at all times the confidentiality of information contained in engagement documentation, unless specific client authority is given to disclose or there is “a legal or professional duty” to disclose. This wording originated from the IFAC wording in *International Statement on Quality Control (ISQC 1)*. From an Australian context there is only a legal duty to disclose as the similar wording in *APES 110: Code of Ethics for Professional Accountants* was amended to remove the professional duty to disclose.

Stakeholders

Engagement personnel involved in carrying out professional services for clients will be impacted by this wording as it is imposing an unintended obligation.

Recommendation

To ensure consistency with the code, in the next version of the standard the wording “or professional” in paragraph 73 (e) should be deleted as there is only a legal duty to disclose.