

AGENDA PAPER

Item Number: 17
Date of Meeting: 14 June 2018
Subject: Update on developments of Quality Control Standards

Action required For discussion For noting For information

Purpose

To provide the Board with an update:

- in respect of the proposed revisions to International Standard on Quality Control (ISQC 1) *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements and Related Services Engagements*; and
- on the impact of these developments on relevant APESB pronouncements.

Background

In line with its Audit Quality initiative, the International Auditing and Assurance Standards Board (IAASB) issued in December 2015 an *Invitation to Comment (ITC): Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control, and Group Audits*.

The ITC included proposals to incorporate a quality management approach (QMA) in ISQC 1 and enhance the requirements relating to Engagement Quality Control Reviews (EQCR). In response to the ITC, APESB made a [submission](#) which underscored our support for the introduction of a QMA in ISQC 1.

IAASB project to revise ISQC 1 and develop ISQC 2

The IAASB, informed by the responses to the ITC, commenced a project in 2016 to revise ISQC 1 which primarily incorporates a QMA into the standard. It is intended to improve a Firm's management of quality relating to its services and enhance ISQC 1's ability to be applied by Firms of different sizes and to a wide range of circumstances.

The IAASB also decided to develop a separate standard on EQCR, proposed International Standard on Quality Control (ISQC 2) *Engagement Quality Control Reviews*. The IAASB proposes to move applicable EQCR provisions from extant ISQC 1 to incorporate these provisions in a new ISQC 2 and enhance them to emphasise the importance of EQCR in audit engagements.

The IAASB considered the latest versions of the proposed Exposure Drafts of ISQC 1 and ISQC 2 at their March 2018 and September 2017 IAASB meetings, respectively. The IAASB expects to release an exposure draft of the proposed revised ISQC 1 in September 2018.

The IAASB has collaborated with the IESBA in respect of their work on ISQC 2, given that the Code includes provisions relating to EQCR (i.e., long association).

Please refer to Appendix 1 for proposed key new provisions in ISQC 1 and ISQC 2.

APESB pronouncements

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

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

Key Considerations

The revisions to ISQC 1 and issue of ISQC 2 will impact APESB pronouncements, in particular, there may be a need for APESB to:

- revise APES 320 based on the new version of ISQC 1;
- develop a new APESB standard based on the new proposed international standard ISQC 2;
- amend APES 325, to ensure that it will not have overlapping provisions with revised APES 320 in respect of risk management issues in Firms; and
- update references to APES 320 and APES 325 in other APESB pronouncements.

Technical Staff notes that the AUASB has issued ASQC 1¹, an auditing standard based on ISQC 1 and applicable to audits/reviews and other assurance engagements conducted in accordance with the *Corporations Act 2001*.

In 2009, APESB and AUASB agreed in principle to take reasonable steps to ensure that the Australian standards issued by the respective Boards are consistent with ISQC 1. In this regard, Technical Staff will need to collaborate with the AUASB in respect of potential revisions to APES 320 (based on the new ISQC 1) and the development of an APESB standard equivalent to ISQC 2.

Technical Staff will continue to monitor the progress of these international developments and commence a project once the international exposure drafts are issued.

Staff Recommendation

That the Board note:

- the progress of the ISQC 1 revision / development of ISQC 2; and
- the potential implications to APESB pronouncements including APES 320 and APES 325.

¹ Refer to Auditing Standard ASQC 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Financial Information, Other Assurance Engagements and Related Services Engagements*.

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Appendix 1

Proposed new provisions in ISQC 1 and ISQC 2

ISQC 1

A new key proposal in the proposed revised ISQC 1 would require Firms to establish and implement a system of quality management. Firms would need to set out quality management objectives and assess quality risks and design and implement responses to quality risks.

This is broader than the extant requirement where Firms must establish and implement a system of quality control, which primarily consists of policies and procedures addressing various elements.

The IAASB believes that the above revisions in ISQC 1 offer more flexibility and will enable Firms of different sizes to develop and implement a system that fits their size and services.

ISQC 2

In ISQC 2, the IAASB proposes to enhance the requirements of extant ISQC 1 relating to the:

- criteria for the eligibility of Engagement Quality Control Reviewers (EQC Reviewers); and
- performance and documentation of the EQCR.

Key proposals in ISQC 2 include:

- a new requirement for Firms to assign the responsibility of appointment of EQC Reviewers to an individual with sufficient knowledge to evaluate whether the eligibility criteria for EQC Reviewers have been met. This is a new requirement in ISQC 2; and
- clarification of extant requirements relating to technical qualifications of EQC Reviewers by explicitly requiring that they must have the appropriate authority to evaluate the significant judgements made by the engagement teams and relevant conclusions through:
 - (i) technical competence and sufficient knowledge of the client's industry; and
 - (ii) sufficient and appropriate experience related to engagements of a similar nature and complexity.