

For the attention of Jim Sylph
International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, NY, 10017
USA

4 January 2008

Dear Sir

IAASB Exposure Drafts – “Quality Control for an Audit of Financial Statements” and “Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements”

We appreciate the opportunity to comment on the IAASB’s Proposed Redrafted ISA 220, *Quality Control for an Audit of Financial Statements* (“proposed redrafted ISA”) and Proposed Redrafted ISQC1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements* (“proposed redrafted ISQC”). Following extensive consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of member firms who commented on these Exposure Drafts. “PricewaterhouseCoopers” refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

Overall comments

We support the proposed redrafted ISA 220 and proposed redrafted ISQC 1 and are, on balance, satisfied that the Clarity drafting conventions have been appropriately applied.

Subject to specific editorial comments set out in the Appendix to this letter, we support the IAASB’s decision to amend ISA 220 and ISQC 1 to conform to ISA 700 by referring to the date of the audit report and removing references to the issuance of the auditor’s report. We also support the IAASB’s decision to adopt the definition of the engagement team that is currently being considered by the IESBA, and the inclusion of the specific reference to auditors’ external experts in paragraph 13 of proposed redrafted ISA 220, to deal with the overall evaluation of the expertise and experience of all those involved in the audit.

However, we have concerns in the following areas, which we urge the IAASB to reconsider before finalising proposed ISQC 1:

- The proposal to establish within proposed ISQC 1 (Redrafted), rather than in the Preface and/or in a separate ISQC, the authority attaching to the ISQC and its various elements.
- The use of ‘shall’ in the proposed redrafted ISQC, and its appropriateness in the context of a standard that is designed to promote a self-monitoring system.

We elaborate on these points below.

We also offer, in the Appendix to this letter, in respect of both proposed redrafted ISA 220 and proposed redrafted ISQC 1, a number of suggestions on specific paragraphs for the IAASB’s consideration in finalising the wording of these standards. These suggestions are set out under the headings “Matters relating to both proposed redrafted ISA 220 and proposed redrafted ISQC 1”, “Matters relating to proposed redrafted ISA 220” and “Matters relating to proposed redrafted ISQC 1”.

Request for Specific Comments

1. Are the objectives to be achieved by the auditor, stated in the proposed redrafted ISA and ISQC appropriate?

We believe that the proposed objectives in the proposed redrafted ISA and ISQC, respectively, are appropriate.

2. Have the criteria identified by the IAASB for determining whether a requirement should be specified been applied appropriately and consistently, such that the resulting requirements promote consistency in performance and the use of professional judgement by auditors?

Subject to the specific comments set out in the Appendix to this letter, we are satisfied that the criteria identified by the IAASB for determining whether a requirement should be specified have been applied appropriately and consistently in the proposed redrafted ISA and ISQC.

Establishing the Authority of the ISQC and its various elements

Addressing the authority in the body of ISQC 1

Paragraphs 4 to 9 of the Introduction describe the Authority of the ISQC and paragraphs 13 to 15 establish requirements on applying and complying with relevant requirements of the proposed ISQC. Both provide context that is important when reading and understanding the objective and requirements of the firm in establishing a system of quality control in accordance with this ISQC. However, we believe that the provisions establishing the authority of the ISQC should be included as an amendment to the Preface, and/or set out in a separate ISQC, rather than in proposed ISQC 1 (Redrafted). As presented, the authority is drafted only in the context of this particular ISQC. This implies that each future ISQC would require this explanation as well, which seems unnecessarily cumbersome.

The recently approved Exposure Draft of ISAE 3402 proposes an amendment to the Preface to establish the authority of the various elements in an ISAE when drafted in Clarity format. It would seem appropriate that a similar amendment be made to address the authority of ISQCs. The reference in paragraph 23 of the current Preface to the fact that the authority of ISQCs is set out in the introduction to the ISQCs was, in a sense, a placeholder based on the extant ISQC. However, it would be appropriate to now amend the Preface based on the Board's deliberations of the appropriate articulation of the authority of the ISQCs and the elements therein.

Equally, the requirements in paragraph 13-15 are important, but we believe that a separate ISQC that serves the same purpose as ISA 200 for the ISQCs would be a preferable means to introduce them into the literature.

Use of "shall" to identify ISQC requirements

The Exposure Draft uses similar wording as in the ISAs to describe the authority attached to requirements in ISQC 1 and it is proposed that "shall" be used to express a requirement. We question both proposals because we do not believe that requirements can serve the same role as requirements in the ISAs.

By its very nature, a firm's quality control system is a behavioural, dynamic system of self-monitoring and self-correction. It involves ongoing assessment, benchmarking and self-correcting actions to achieve a sound basis for quality control. Compliance within such a system is, of necessity, different from compliance within the context of auditing standards, where a failure to perform a required procedure has implications for audit quality and may affect the auditor's ability to express an opinion on the financial statements. At any point in time, in a quality control system, there are likely to be inadvertent breaches or deficiencies, or policies and procedures that may need to be strengthened. The effectiveness of the system depends on the deficiencies being identified on a timely basis and ensuring the appropriate people within the firm are informed so that they can take appropriate action to address them. Compensating actions can be taken to address a particular deficiency and mitigate its effect, enabling the firm to meet the objective of the firm's system of quality control, as articulated in ISQC 1. Whilst it is possible to say that a firm has policies and procedures designed to comply with ISQC 1, it is not possible to assert that the firm "complies with ISQC 1", without further explanation of what that means.

It is for these reasons that we are concerned that establishing 'must do' requirements is not consistent with the aim of the ISQC – particularly when no recognition has been given to the fact that departures from requirements may occur (which is recognised in the ISAs). Treating requirements in the ISQC in the same way as they are in the ISAs establishes expectations about a firm's quality control policies and procedures that are not attainable within the context of a dynamic, self-improving process.

We recommend that the description of the authority of requirements in paragraph 14 be amended to reflect that they represent the expectations of an effective system of quality control and that, when departures from a requirement are found, the firm needs to respond on a timely basis to address both the immediate effect and to strengthen the policies and procedures to avoid future departures. We also suggest that a different term than "shall" should be used for ISQC requirements – perhaps "should" – to avoid any confusion regarding the fundamental difference between an ISA requirement and an ISQC requirement.

We would be happy to discuss our views further with you. If you have any questions regarding this letter, please contact Roger Marshall (+44 20 7804 4866).

Yours faithfully,

PricewaterhouseCoopers

Matters relating to both proposed redrafted ISA 220 and ISQC 1	
Paragraph	Comment on paragraph
	Definitions
6 (c) of proposed ISA 220; 12 (d) of proposed ISQC 1	<p>These paragraphs have introduced to the definition of the engagement quality control reviewer the clause "none of whom is part of the engagement team". Whilst this potentially aids clarity, we note that, under the IFAC Code of Ethics, it is the "audit team" that is required to be independent. In that context, the audit team includes both the "engagement team" and the engagement quality control reviewer. Proposed ISA 220 and ISQC 1, however, focus on the narrower "engagement team", which excludes the engagement quality control reviewer and many other people. We question whether this difference is intentional as it could have implications for independence requirements.</p>
	Engagement Performance
15 of proposed ISA 220; 39 of proposed ISQC 1	<p>Whilst we agree with the principle of elevating the present tense extant paragraph 25 to a requirement in paragraph 15 of proposed redrafted ISA 220 and, similarly, in paragraph 39 of proposed redrafted ISQC 1, we believe clarification is needed in respect of documentation which is administrative in nature or inconsequential to the audit opinion, but which is prepared by a senior member of the engagement team. In such a case, the current requirements suggest that the engagement partner would be expected to review the documentation as the engagement partner would be the only "more experienced team member". If this is the intention, it would appear to be inconsistent with paragraph A13 of the proposed redrafted ISA, which recognises that the engagement partner need not review all audit documentation, but rather focuses his or her review to critical areas of judgement, significant risks and other areas the engagement partner considers important, and with paragraph A19 of ISA 230, which recognises that the requirement to document who reviewed the audit work does not imply a need for each specific working paper to include evidence of review.</p> <p>We believe there can be limited circumstances for documentation of an administrative or inconsequential nature when review by a more experienced team member is not necessary. We recommend that the application material in ISA 220 and ISQC 1 be aligned with redrafted ISA 230 to clarify that the engagement partner should use professional judgement when determining whether it is necessary to review specific working papers in such circumstances. In addition, as illustrated below, we believe some editing of the wording of these requirements would help avoid the implication of all work requiring review.</p> <p>Further, although it may be good practice for work to be reviewed 'on a timely basis', we do not believe that it is necessary in all circumstances for work to be reviewed on completion of the relevant working paper in order to achieve the overall objective of the auditor. What is important is that the review has occurred before the date of the audit opinion to ensure that sufficient appropriate audit evidence has been obtained and taken into account when forming the audit opinion. We believe that extant ISA 220 and ISQC 1 were correct in discussing timeliness in the explanatory guidance, and suggest that it be deleted from the requirements. ISA 220 Paragraph A13 already explains why timely reviews are good practice.</p> <p>To address these suggestions, we recommend the following changes to the requirements:</p> <p>ISA 220, paragraph 15: "<i>Review responsibilities shall be determined on a basis that the work of a less experienced team members is reviewed on a timely basis by a more experienced team members.</i>"</p> <p>ISQC 1, paragraph 39: "<i>Review responsibility policies and procedures shall be determined on a basis that the work of a less experienced team members is reviewed on a timely basis by a more experienced team members.</i>"</p>
16 of proposed ISA 220	<p>Paragraph 16 requires: "Before the date of the auditor's report, the engagement partner shall.....be satisfied that sufficient appropriate audit evidence has been obtained...." Read literally, this would require all evidence supporting the conclusions to be obtained no later than one day prior to the date of the report. However, in practice, it is conceivable that final audit evidence might be obtained on the same day as the date of the audit report, for example, there might be one outstanding matter that requires a representation signed by the board at a meeting at which the financial statements are also approved. We suggest revising this paragraph as follows:</p> <p><i>"Before the <u>audit report is dated</u> date of the auditor's report, the engagement partner shall, through a timely review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached. and for the auditor's report to be issued."</i></p>

Matters relating to both proposed redrafted ISA 220 and ISQC 1	
	<p>In the same paragraph, we recommend that the words “and for the auditor's report to be issued” be deleted, as indicated above, as they then become unnecessary.</p> <p>If the above suggestions are accepted, consequent amendment to both the definition of “Engagement quality control review” and paragraph A13 of the Application and Other Explanatory Material will be needed.</p>
<p>19 (c) and 27(b) of proposed ISA 220; 41(d) and 49 (b) of proposed ISQC 1</p>	<p>Paragraph 19 (c) notes that the auditor's report should not be dated until the completion of the engagement quality control review and paragraph 27 (b) requires documentation that the engagement quality control review has been completed before the date of the auditor's report. Similar wording is used in the requirements in paragraphs 41 (d) and 49 (b) of ISQC 1.</p> <p>As the engagement quality control review is an integral of the quality control over the audit, including ensuring that sufficient appropriate audit evidence has been achieved, these requirements make sense.</p> <p>However, ISA 230 on Audit Documentation acknowledges that changes to audit documentation can be made after the date of the auditor's report to document audit evidence that the auditor has obtained, discussed and agreed with the relevant members of the audit team before the date of the auditor's report. This may relate to resolution of significant issues that are resolved close to the finalisation of the audit and signing of the auditor's report. Whilst it is important that, where the matters are significant, the engagement quality control reviewer is satisfied with their resolution prior to the date of the auditor's report, the reviewer may nevertheless want to review that final documentation of that matter. In such circumstances, it would seem acceptable that documentation of the <u>final</u> completion of the engagement quality control review occurs at that time.</p> <p>We suggest that the application guidance specifically address this situation to avoid any confusion regarding the interrelationship between ISA 220/ISQC 1 and ISA 230 in this respect.</p>
<p>27 of proposed ISA 220</p>	<p>Paragraph 27 of proposed ISA 220 requires the engagement quality control reviewer to document that the engagement quality control review has been completed before the date of the auditor's report. For similar reasons to that described for paragraph 16, in practice, it is conceivable that the engagement quality control reviewer might complete the review on the same day as the date of the audit report. We therefore suggest revising paragraph 27 (b) as follows:</p> <p><i>“The engagement quality control review has been completed before the date of the auditor's report is dated;...”</i></p> <p>This would achieve greater consistency with paragraph 19 of the proposed redrafted ISA, which requires the engagement partner not to date the auditor's report until completion of the engagement quality control review.</p>
<p>49 of proposed ISQC 1</p>	<p>For the same reason, we suggest revising paragraph 49 (b) of proposed redrafted ISQC 1 to read:</p> <p><i>“The engagement quality control review has been completed before the date of the report <u>audit report is dated</u>; ...”</i></p> <p>with consequent revisions to both the definition of ‘Engagement quality control review’ and paragraph A39 of the Application and Other Explanatory Material. This would achieve greater consistency with paragraph 41 (d) of the proposed redrafted ISQC and paragraph 19 (c) of proposed redrafted ISA 220, which require that the audit report not be dated until completion of the engagement quality control review.</p> <p>Also see the comments above regarding paragraphs 19 (c) and 27(b) of proposed ISA 220 regarding the need for clarification of engagement quality control review of documentation completed after the date of the auditor's report.</p>
	<p>Consultation</p>
<p>18 of proposed ISA 220</p>	<p>Consistent with other recently redrafted ISAs, present tense paragraphs relating to documentation have been elevated and compiled in a single section of the requirements in proposed redrafted ISA 220. However, to assist clarity and preserve the requirement, in extant ISA 220 paragraph 33, for the documentation of consultations to be agreed with the party consulted, we recommend that paragraph 18 (c) of proposed ISA 220 be revised as follows:</p>

<i>Matters relating to both proposed redrafted ISA 220 and ISQC 1</i>	
	<i>"Be satisfied that the nature, and scope of, and conclusions resulting from, <u>and documentation of</u>, such consultations are agreed with the party consulted."</i>
<i>40 of proposed ISQC 1</i>	<p>Paragraph 40 (c) of proposed redrafted ISQC 1 requires: "The nature and scope of such consultations are documented and are agreed by both the individual seeking consultation and the individual consulted..." Extant ISQC 1 paragraph 51 requires that "the nature and scope of such consultations are documented", while extant ISQC 1 paragraph 56 deals with the agreement by both the individual seeking consultation and the individual consulted.</p> <p>It appears that paragraph 40 (c) is an attempt to deal with both extant 51 and part of extant 56 in one paragraph. However, we believe that clarity has been lost by doing this, as paragraph 40 (c) now suggests that it is the nature and scope of the consultation that require agreement by both the individual seeking consultation and the individual consulted, whereas extant paragraph 56 clearly deals with the agreement of the <u>documentation</u>.</p> <p>Furthermore there is an inconsistency with paragraph 18 (c) of proposed redrafted ISA 220, which requires the nature, scope <u>and conclusions</u> to be agreed with the party consulted.</p> <p>We suggest that paragraph 40 (c) of proposed ISQC 1 be revised as follows:</p> <p><i>"The nature, and scope, <u>conclusions and documentation</u> of such consultations are documented and are agreed by both the individual seeking consultation and the individual consulted; .."</i></p> <p>As a consequence, paragraph 40 (d) would require revision to read as follows:</p> <p><i>"Conclusions resulting from consultations are documented and implemented."</i></p>

Matters relating to proposed redrafted ISA 220	
	Monitoring
25	<p>This paragraph requires the engagement partner to consider the results of the monitoring process as evidenced in the latest information circulated by the firm, and to determine whether there are any deficiencies noted that might affect the audit engagement and whether any additional procedures are required. Although we agree with the elevation of this paragraph to a requirement, we have some concerns about how it has been drafted.</p> <p>The first sentence of this requirement is a quote from ISQC 1. Including this reference in the body of an ISA requirement may create ambiguity regarding the interrelationship between ISQCs and ISAs. In particular, it could imply that a deficiency in the firm's quality control policies and procedures affects whether or not an audit has been conducted in accordance with the ISAs. As noted in paragraph A22, a deficiency in the firm's system of quality control does not necessarily indicate that a particular engagement was not performed in accordance with standards.</p> <p>To avoid any ambiguity regarding the authority of that essential application guidance regarding ISQC 1 when it is placed within the body of the ISA, we suggest that it be deleted from paragraph 25 of proposed ISA 220.</p> <p>Further, we consider that some of the clarity has been lost by replacing extant ISA 220 paragraph 41 (b) which reads: "Whether the measures the firm took to rectify the situation are sufficient in the context of the audit", with the following: "whether.....any additional procedures are required." We believe that the latter could be interpreted as imposing a new requirement on engagement partners to determine whether any new procedures are required in the firm's system of quality control, but that the intention is to refer to additional audit procedures in the specific audit in question.</p> <p>To address these suggestions, the requirement could be rewritten as follows:</p> <p><i>"[Proposed] ISQC 1 (Redrafted) requires the firm to 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 and complied with in practice. The engagement partner shall consider the results of the firm's monitoring process of its policies and procedures relating to the system of quality control, as evidenced in the latest information circulated by the firm, and, if applicable, other network firms, and shall determine whether:</i></p> <p><i>(a) Deficiencies <u>reported</u> noted in that information may affect the audit engagement; and</i></p> <p><i>(b) Any additional procedures are required <u>in the performance of the audit</u>, as a result"</i></p>
	Acceptance and Continuance
A5	<p>We support the treatment of extant ISA 220 paragraph 16 as application material on the grounds that it may not be the engagement partner who makes the acceptance or continuance decisions. However, by deleting extant paragraph 15, it is unclear why the engagement partner is not required, in all cases, to consider the factors set out in proposed paragraph A5. We consider that clarity would be enhanced by retaining the first sentence of extant paragraph 15 as part of proposed paragraph A5 as follows:</p> <p><i>"[Proposed] ISQC 1 (Redrafted) requires the firm to obtain information considered 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. <u>Although the engagement partner may or may not initiate the decision-making process for acceptance or continuance regarding the audit engagement,</u> ↓ information such as the following assists the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate:...."</i></p>

Matters relating to proposed redrafted ISQC 1	
	Elements of a System of Quality Control
17	<p>Whilst we agree that the firm’s quality control policies and procedures should be documented and communicated to the firm’s personnel, we question whether it is necessary for the requirement to specify what that communication should describe. We believe this is more appropriately included in the application guidance.</p>
	Human Resources
35	<p>Paragraph 35 or proposed redrafted ISQC 1 requires the firm to “establish policies and procedures regarding assessment of its <u>staff’s</u> capabilities and competence designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence and commitment to ethical principles....” Paragraph 12 (q) of the proposed redrafted ISQC defines “staff” as “professionals, other than partners, including any experts the firm employs”.</p> <p>Extant ISQC 1 (paragraph 36) requires the firm to 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....”, the intention being that the firm needs to have in place human resources policies and procedures to assess the capabilities of its <u>partners and staff</u>.</p> <p>Whilst, arguably, this is covered in paragraph 36 of the proposed redrafted ISA, the reference only to “staff” in the first sentence of paragraph 35 of the proposed redrafted ISA creates an ambiguity.</p> <p>Further, assessing capabilities and competence to obtain reasonable assurance of the <u>sufficiency</u> of personnel is not the same as assessing whether the engagement partner has the appropriate capabilities to perform a <u>particular engagement role</u> as dealt with in paragraph 36 of the proposed redrafted ISA.</p> <p>We suggest retaining the wording in extant ISQC 1 paragraph 36 or, alternatively, revising paragraph 35 of proposed redrafted ISQC 1 as follows:</p> <p><i>“The firm shall establish policies and procedures regarding assessment of its <u>personnel’s staff’s</u> capabilities, and competence and commitment to ethical principles designed to provide it with reasonable assurance that it has sufficient personnel with the<u>such</u> capabilities, competence, and commitment to ethical principles necessary to:....”</i></p>
	Engagement Performance
38	<p>This paragraph requires the firm to “establish policies and procedures designed to provide it with reasonable assurance that engagements are <u>consistently</u> performed in accordance with professional standards and regulatory and legal requirements....” Extant paragraph 46 does not include the word ‘consistently’.</p> <p>Whilst we agree that a process of quality control should be designed to assess whether all engagements are performed to a required standard (i.e. are consistent in their quality), the word ‘consistently’ could be taken to imply that this requirement is to be achieved in a standardised way, which is not necessarily appropriate given the range of engagements to which ISQC 1 applies. We offer the following as an alternative:</p> <p><i>“The firm shall establish policies and procedures designed to provide it with reasonable assurance that engagements are consistently performed <u>to a consistent quality</u> in accordance with professional standards and regulatory and legal requirements, and that the firm or the engagement partner issue reports that are appropriate in the circumstances.”</i></p>