

Overview of Proposed ISA 220 (Revised), Quality Management for an Audit of Financial Statements

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In February 2019, the International Auditing and Assurance Standards Board (IAASB) issued the quality management exposure drafts (QM-EDs). Proposed ISA 220 (Revised), *Quality Management for an Audit of Financial Statements* (ED-220) was included as part of the package of QM-EDs. This article in the series of articles on the QM-EDs provides an overview of the proposed requirements contained in ED-220.

Background to ED-220

One of the main objectives of the IAASB's quality management project was to address public interest considerations and this was no different in revising ISA 220, *Quality Control for an Audit of Financial Statements* (ISA 220). While the Proposed International Standard on Quality Management, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements or Other Assurance or Related Services Engagement* (ED-ISQM 1) establishes the overall requirements, ED-220 includes the specific requirements on how quality management should be implemented at engagement level. In line with the change to the title of the international standard from *quality control* to *quality management*, the proposed requirements contained in ED-220 encourage proactive management of quality at the engagement level.

The goals set by the IAASB in revising ISA 220 included the following:

- Emphasis of the importance of the appropriate application of professional judgement and, where appropriate, professional scepticism;
- Clarify the role and responsibilities of the engagement partner, specifically the required involvement throughout the audit, while retaining the emphasis on the engagement partner's responsibility for managing and achieving quality at engagement level;
- Modernising ISA 220 for an evolving environment; and
- Clarifying the relationship between ED-220 and firm level quality management standards.

The paragraphs that follow provide a more detailed overview of these goals.

Professional judgement and professional scepticism

The auditor is tasked with serving the public interest and this is best achieved through the consistent performance of quality engagements. ED-220 includes new guidance on the importance of the use of professional scepticism and professional judgement in performing audit engagements that recognises that professional scepticism supports the quality of judgements made by the engagement team and, through these judgements, supports the overall effectiveness of the engagement team in achieving quality at engagement level¹.

¹ ED-220, para. 7

Material describing possible impediments to professional scepticism, auditor biases, as well as actions that the engagement partner can take to deal with such impediments has been included in the related application paragraphs, as follows.

Impediments to the exercise of professional scepticism at engagement level include:

- Tight deadlines or budget constraints;
- Lack of cooperation or undue pressure imposed by management;
- Insufficient emphasis on the importance of quality;
- Insufficient understanding;
- Difficulties in obtaining access to required information or persons; and
- Overreliance on tools and templates².

Auditor biases that may affect the engagement team's professional judgements include:

- Availability bias – considering information that is easily retrievable from memory as being more likely, more relevant and more important for judgement;
- Confirmation bias – seeking and treating information that is consistent with initial beliefs or preferences as more persuasive;
- Overconfidence bias – overestimating one's own ability; and
- Anchoring bias – making assessments by starting from an initial numerical value and then adjusting insufficiently away from the initial value in forming a final judgement³.

Actions that the engagement partner can take to deal with the impediments to the exercise of professional scepticism at engagement level include:

- Remaining alert to changes in the nature and circumstances of the audit engagement;
- Explicitly alerting the engagement team to instances or situations when vulnerability to auditor biases may be greater;
- Involving more experienced members or members with specialised skills; and
- Modifying the nature, timing and extent of the direction and supervision of the engagement team and the review of their work⁴.

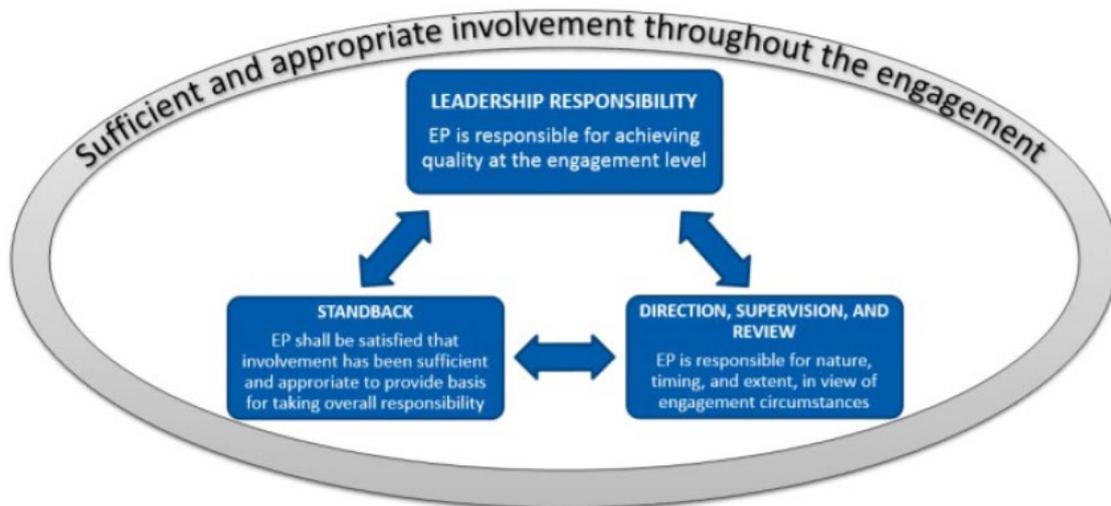
Role and responsibilities of the engagement partner

Appropriate involvement of engagement partner throughout the audit engagement is seen as fundamental to achieving the desired level of audit quality. While extant ISA 220 requires the engagement partner to take responsibility for the overall quality of each assigned audit engagement, a need to make the engagement partners responsibilities more explicit was noted. The Explanatory Memorandum to ED-220 includes the following diagram to illustrate how sufficient and appropriate involvement of engagement partner throughout the engagement results in fulfilling the overall responsibility of achieving audit quality.

² ED-220, para.A27

³ ED-220, para.A28

⁴ ED-220, para. A29 (extract)



The overall responsibility of the engagement partner includes:

- **Leadership responsibility** at the engagement level. ED-ISQM 1 requires governance and leadership to establish and embed a culture at firm level that is conducive to and promotes commitment to quality. ED-220 builds on this in requiring the engagement partner to establish an environment for the engagement that emphasises the firm culture and communicates the expected behaviour of the engagement team.
- Ultimate responsibility for the nature, timing and extent of the **direction, supervision and review** activities required to support the engagement performance.
- **Standing back** to determine that the involvement throughout the audit engagement has been sufficient and appropriate in providing a basis for taking overall responsibility for audit quality at engagement level.

Modernising ISA 220

The environment in which audit, assurance and other related service engagements are performed is continuously changing and the resources used in performing such engagements is evolving. As part of the quality management project, the IAASB were tasked with modernising the standards to address the needs of the evolving and increasingly complex environment. In modernising the engagement level quality management standard, ED-220 now recognises that engagement teams may be organised in a variety of ways and the individuals involved in the audit engagement may not necessarily be engaged or employed directly by the firm. Regardless of how the engagement team is arranged, ED-220 recognises that if individuals are performing audit procedures, their work needs to be appropriately directed, supervised and reviewed. The definition of *engagement team* has also been revised to accommodate the various ways that the engagement team may be organised and clarify which individuals are considered to be part of this team.

In line with the increased use of technology in audit engagements, the requirements included under the *Resources* section have been expanded to include technology and intellectual resources, while retaining the extant requirements relating to human resources. This change is consistent with the changes proposed in ED-ISQM 1.

Clarifying the relationship between the quality management standards

ED-ISQM 1 includes the requirements applicable at firm level relating to establishing the system of quality management. Here, the firm is required to establish quality objectives, identify and assess quality risks and design and implement responses to address the assessed quality risks. These responses may be implemented at either firm or engagement level. To facilitate this process, ED-ISQM 1 includes a requirement for the firm to communicate relevant information to the engagement team about their specific responsibilities regarding firm level responses that are required to be implemented at engagement level.

With respect to the performance of engagement quality reviews (EQR), extant ISA 220 contains the requirements and guidance on the performance of the EQR (formerly known as an engagement quality control review). In the QM-EDs, this has changed. The requirements and guidance on the performance of an EQR of the audit have been moved out of ED-220 and included in Proposed ISQM 2, Engagement Quality Reviews (ED-ISQM 2). ED-220 now only focuses on the responsibilities of the engagement partner with respect to the EQR.

Extant ISA 220 indicates that engagement teams are allowed to rely on the firm's system of quality control, unless information provided by the firm or other parties suggest otherwise. To avoid the risk of the engagement team blindly relying on the firm's system of quality management, this has been moved to the application material of ED-220 and rephrased to state that in certain circumstances, the engagement partner may depend on the firm's policies and procedures in complying with the requirements of ED-220⁵. The application material has further been expanded on to include guidance on examples of matters that the engagement team may take into account in determining when firm policies and procedures can be relied on.

In concluding

ED-220 forms part of the suite of the QM-EDs. While ED-ISQM 1 includes the requirements for the firm to establish a system of quality management, ED-220 deals with the specific responsibilities of the engagement partner in relation to quality management at engagement level. ED-220 is a mere seven pages long and at face value, may appear that little has changed. Auditors are encouraged not to underestimate the proposed changes and invest the time required to become closely acquainted with the proposed requirements, sooner rather than later.

⁵ ED-220, para.A7-A8