

Guidance Note on Compliance Reviews under ‘Clarified’ ISQC 1

**Issued by the Quality Assurance Oversight Committee
February 2011**

Introduction

Section 1 – The Review Cycle

- 1.1 Relevant Extracts from the Previous ISQC 1 on the Review Cycle**
- 1.2 Relevant Extracts from the ‘Clarified’ ISQC 1 on the Review Cycle**
- 1.3 Previous Interpretation on the Review Cycle**
- 1.4 Interpretation on the Review Cycle under ‘Clarified’ ISQC 1**

Section 2 – The Reviewer

- 2.1 Relevant Extracts from the Previous ISQC 1 on the Reviewer**
- 2.2 Relevant Extracts from the ‘Clarified’ ISQC 1 on the Reviewer**
- 2.3 Previous Interpretation on the Reviewer**
- 2.4 Interpretation on the Reviewer under ‘Clarified’ ISQC 1**

Executive Summary

Guidance Note on Compliance Reviews under 'Clarified' ISQC 1

Introduction

The purpose of this Guidance Note is to determine the review cycle for the monitoring process designed to test the relevance, adequacy and effective implementation of the quality control policies and procedures of the firm or sole practitioner under 'clarified' ISQC 1. Such monitoring process is hereinafter referred to as the audit compliance review. Besides a whole practice review, an audit compliance review includes the inspection of a selection of completed audit engagements, hereinafter referred to as cold file reviews. The review cycle is covered in Section 1 of this Guidance Note.

Section 2 of this Guidance Note identifies who can perform compliance reviews under 'clarified' ISQC 1.

Section 1 – The Review Cycle

1.1 Relevant Extracts from the Previous ISQC 1 on the Review Cycle

74. *The firm should 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. Such policies and procedures should include **an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements.***

78. *The inspection of a selection of completed engagements is ordinarily performed on a cyclical basis. **Engagements selected for inspection include at least one engagement for each engagement partner over an inspection cycle, which ordinarily spans no more than three years.** The manner in which the inspection cycle is organized, including the timing of selection of individual engagements, depends on many factors, including the following:*

- *The size of the firm.*
- *The number and geographical 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.*

85. ***At least annually**, the firm should 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 chief executive officer or, if appropriate, its managing board of partners.*

1.2 Relevant Extracts from the 'Clarified' ISQC 1 on the Review Cycle

48. *The firm shall establish a monitoring process designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively. This process shall:*

- (a) **Include an ongoing consideration and evaluation of the firm's system of quality control including, on a cyclical basis, inspection 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 engagement quality control review are not involved in inspecting the engagements.*

53. *The firm shall communicate **at least annually** the results of the monitoring of its system of quality control to engagement partners and other appropriate individuals within the firm, including the firm's chief executive officer or, if appropriate, its managing board of partners.*

Guidance Note on Compliance Reviews under 'Clarified' ISQC 1

A66. *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.*

A67. *The inspection process includes the selection of individual engagements, some of which may be selected without prior notification to the engagement team. 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.*

1.3 Previous Interpretation on the Review Cycle

The previous ISQC 1 stated that the results of the monitoring process should be communicated annually throughout the firm (para. 85). Based on this, firms and practitioners were being advised that audit compliance reviews (including cold file reviews) should be carried out annually. Firms with more than one audit engagement partner were being advised to select one audit file for inspection from each audit engagement partner at least once every three years.

1.4 Interpretation on the Review Cycle under 'Clarified' ISQC 1

ISQC 1 refers to the results of the monitoring process which should be communicated *annually* throughout the firm.

It is the interpretation of the Quality Assurance Oversight Committee that para. 53 of 'clarified' ISQC 1 does not apply to sole practitioners with no employees or subcontracted staff involved on audit work (where no 'communication' is required) and having no public interest entities as audit clients. Therefore, in such cases, the audit compliance review (including a cold file review) may be conducted once every three years.

This interpretation is also based in light of 'clarified' ISQC 1 which allows "smaller firms" to "use more informal methods in the documentation of their systems of quality control" (para. A75). It stands to reason that, in such cases, compliance reviews in relation to the system of quality control are also more informal and less frequent.

In the case of sole practitioners with audit staff (employed or sub-contracted), the audit compliance review should be carried out annually and cold file reviews carried out at least once every three years.

Guidance Note on Compliance Reviews under 'Clarified' ISQC 1

In the case of firms with more than one audit engagement partner, the audit compliance review (including at least one cold file review) should be carried out annually. One audit file from each audit engagement partner should be selected for inspection at least once every three years.

In all cases, the visit conducted by the Quality Assurance Unit does not act as a substitute for the monitoring process of the firm / sole practitioner.

In view of the changes expected to be brought about by the implementation of the clarified ISAs, the Quality Assurance Oversight Committee still recommends the conduct an audit compliance review (including cold file reviews) as soon as the clarified ISAs set in.

Section 2 – The Reviewer

2.1 Relevant Extracts from the Previous ISQC 1 on the Reviewer

76. *The firm entrusts responsibility for the monitoring process to a partner or partners or other persons with sufficient and appropriate experience and authority in the firm to assume that responsibility. Monitoring of the firm's system of quality control is performed by competent individuals and covers both the appropriateness of the design and the effectiveness of the operation of the system of quality control.*

79. *The inspection process includes the selection of individual engagements, some of which may be selected without prior notification to the engagement team. **Those inspecting the engagements are not involved in performing the engagement or the engagement quality control review.** 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.*

80. *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.*

2.2 Relevant Extracts from the 'Clarified' ISQC 1 on the Reviewer

48. *The firm shall establish a monitoring process designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively. This process shall:*

- (a) Include an ongoing consideration and evaluation of the firm's system of quality control including, on a cyclical basis, inspection 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 engagement quality control review are not involved in inspecting the engagements.***

A68. *In the case of small firms, monitoring procedures may need to be performed by individuals who are responsible for design and implementation of the firm's quality control policies and procedures, or who may be involved in performing the engagement quality control review. A firm with a limited number of persons may choose to use a suitably qualified external person or another firm to carry out engagement inspections and other monitoring procedures. Alternatively, the firm may establish arrangements to share resources with other appropriate organizations to facilitate monitoring activities.*

Guidance Note on Compliance Reviews under 'Clarified' ISQC 1

2.3 Previous Interpretation on the Reviewer

Firms and practitioners were being advised that audit compliance reviews may be carried out internally by the firm / sole practitioner themselves or by the engagement quality control reviewer. Contrary to the requirements of para. 79 (of the previous ISQC 1), firms and practitioners were also being advised that cold file reviews could be carried out internally by those performing the engagement or by the engagement quality control reviewer.

2.4 Interpretation on the Reviewer under 'Clarified' ISQC 1

'Clarified' ISQC 1 expressly allows monitoring procedures to be carried out by the individual responsible for the design and implementation of the firm's quality control policies and procedures or by the engagement quality control reviewer in the case of small firms (para. A68). Therefore, the audit compliance review may still be carried out internally both by sole practitioners and firms. However, it is the interpretation of the Quality Assurance Oversight Committee that cold file reviews should be carried out by a person who was not involved on the engagement or the engagement quality control review.

Therefore, in the case of a sole practitioner with no staff, the cold file review should be carried out by an external person, provided that such person had not acted as an engagement quality control reviewer on that audit. The Quality Assurance Oversight Committee encourages arrangements between practitioners to review each other's completed audit files.

In the case of a sole practitioner employing staff, the practitioner cannot carry out the cold file review but may make arrangements for an employee (who was not involved on the audit) to carry out the review as long as the staff member is a holder of a practicing certificate in auditing, is experienced in current auditing requirements, did not act as an engagement quality control reviewer on that engagement and as long as the selection criteria are not compromised. Otherwise, such a sole practitioner should use an external reviewer, provided that such person had not acted as an engagement quality control reviewer on that audit.

In the case of a firm, partners may carry out cold file reviews as long as they were not involved on that audit or acted as engagement quality control reviewer on that audit.

In all cases, the reviewer should be a holder of a practicing certificate in auditing and technically competent on audit-related matters.

Guidance Note on Compliance Reviews under 'Clarified' ISQC 1

Executive Summary

Sole practitioners with no employees or subcontracted staff involved on audit work and having no public interest entities as audit clients should carry out an audit compliance review (including a cold file review) at least once every three years. The audit compliance review may be carried out by the practitioner. However, cold file reviews should be carried out by an external person, provided that such person had not acted as an engagement quality control reviewer on that audit.

In all other cases, a whole practice review should be carried out annually (and can be conducted internally).

In the case of a sole practitioner with staff, the cold file review may be carried out at least once every three years by an employee who was not involved on the audit as long as the staff member is a holder of a practicing certificate in auditing and is experienced in current auditing requirements, did not act as an engagement quality control reviewer on that engagement and as long as the selection criteria are not compromised. Otherwise, such a sole practitioner should use an external reviewer, provided that such person had not acted as an engagement quality control reviewer on that audit.

In the case of a firm, partners may carry out cold file reviews as long as they were not involved on that audit or acted as engagement quality control reviewer on that audit. Cold file reviews should be carried out as part of the annual audit compliance review process. One audit file from each audit engagement partner should be selected for inspection at least once every three years.

Summary		Audit Compliance Review	
		Whole Practice Review	Cold File Review
Sole practitioner – with no audit staff	Frequency	Once every 3 years (minimum)	Once every 3 years (minimum)
	Reviewer	Internal or External	External (not EQCR reviewer)
Sole practitioner – with audit staff	Frequency	Annually	Once every 3 years (minimum)
	Reviewer	Internal or External	Internal or external (reviewer not involved on audit/EQCR)
Firm – with no audit staff	Frequency	Annually	Annually (each partner once every 3 years - minimum)
	Reviewer	Internal or External	Internal or external (reviewer not involved on audit/EQCR)
Firm – with audit staff	Frequency	Annually	Annually (each partner once every 3 years - minimum)
	Reviewer	Internal or External	Internal or external (reviewer not involved on audit/EQCR)