
EXPOSURE DRAFT

PROPOSED STATEMENTS ON QUALITY MANAGEMENT STANDARDS — QUALITY MANAGEMENT:

*A Firm's System of Quality Management
Engagement Quality Reviews*

PROPOSED STATEMENT ON AUDITING STANDARDS

*Quality Management for an Engagement Conducted in
Accordance With Generally Accepted Auditing
Standards*

QUALITY MANAGEMENT

AICPA, Professional Standards, QC sec. 20

- ***Supersedes:***
 - ***Statement on Quality Control Standards No. 8, A Firm’s System of Quality Control (AICPA, Professional Standards, QC sec. 10)***
 - ***Statement on Auditing Standards (SAS) No. 122, Statements on Auditing Standards: Clarification and Recodification, as amended, section 220, Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards (AICPA, Professional Standards, AU-C sec. 220)***
- ***Amends SAS No. 117, Compliance Audits, as amended (AICPA, Professional Standards, AU-C sec. 935)***
- ***Amends the following sections of SAS No. 122, as amended:***
 - ***Section 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance Generally Accepted Auditing Standards (AICPA, Professional Standards, AU-C sec. 200)***
 - ***Section 210, Terms of Engagement (AICPA, Professional Standards, AU-C sec. 210)***
 - ***Section 230, Audit Documentation (AICPA, Professional Standards, AU-C sec. 230)***
 - ***Section 260, The Auditor’s Communication With Those Charged With Governance (AICPA, Professional Standards, AU-C sec. 260)***
 - ***Section 300, Planning an Audit (AICPA, Professional Standards, AU-C sec. 300)***
 - ***Section 600, Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors) (AICPA, Professional Standards, AU-C sec. 600)***
 - ***Section 620, Using the Work of an Auditor’s Specialist (AICPA, Professional Standards, AU-C sec. 620)***
 - ***Section 930, Interim Financial Information (AICPA, Professional Standards, AU-C sec. 930)***
- ***Amends SAS No. 130, An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements, as amended (AICPA, Professional Standards, AU-C sec. 940)***

- ***Amends the following sections of SAS No. 134, Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements, as amended:***
 - *Section 700, Forming an Opinion and Reporting on Financial Statements (AICPA, Professional Standards, AU-C sec. 700)*
 - *Section 701, Communicating Key Audit Matters in the Independent Auditor's Report (AICPA, Professional Standards, AU-C sec. 701)*
- ***Amends SAS No. 136, Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA, as amended (AICPA, Professional Standards, AU-C sec. 703)***
- ***Amends SAS No. 137, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports, as amended (AICPA, Professional Standards, AU-C sec. 720)***
- ***Amends SAS No. 142, Audit Evidence (AICPA, Professional Standards, AU-C sec. 500)***
- ***Amends Statement on Standards for Attestation Engagements No. 18, Attestation Standards: Clarification and Recodification, as amended, section 105, Concepts Common to All Attestation Engagements (AICPA, Professional Standards, AT-C sec. 105)***

February 4, 2021

**Comments are requested by August 31, 2021
(Extended From June 11, 2021)**

**Prepared by the AICPA Auditing Standards Board for comment from persons interested
in auditing and reporting issues.**

Comments should be addressed to Sherry Hazel at CommentLetters@aicpa-cima.com.



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Explanatory Memorandum

Introduction

This memorandum provides background to the following three standards for quality management at the firm and engagement levels (collectively, the proposed QM standards):

- Proposed Statement on Quality Management Standards (SQMS), *A Firm's System of Quality Management* (hereinafter referred to as *proposed SQMS No. 1* for purposes of this memorandum).
- Proposed SQMS, *Engagement Quality Reviews* (hereinafter referred to as *proposed SQMS No. 2* for purposes of this memorandum)
- Proposed Statement on Auditing Standards *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards* (QM SAS)

If issued as final, proposed SQMS No.1 will supersede Statement on Quality Control Standards (SQCS) No. 8, *A Firm's System of Quality Control* (QC section 10), and proposed QM SAS will supersede SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*, as amended, section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards* (AU-C section 220).¹

Background

The Auditing Standards Board (ASB) last made significant changes to its quality control standards in October 2006 with the issuance of SQCS No. 7, *A Firm's System of Quality Control*, superseding all previously issued SQCSs. SQCS No. 7 converged with the International Auditing and Assurance Standards Board's (IAASB) International Standard on Quality Control (ISQC) 1, *Quality Control for Firms That Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*. In November 2010, SQCS No. 8 was issued and superseded SQCS No. 7. SQCS No. 8 applied the ASB's clarity drafting conventions to SQCS No. 7 without changing or expanding it in any significant respect.

Since then, the environment in which firms operate has evolved. The power and use of technological resources have increased exponentially, both by businesses and by firms. The expectations of regulators, given high-profile business failures, are higher. In addition, the ASB has received feedback that SQCS No. 8 has a "one size fits all" approach that doesn't adapt well to differences in the size or nature of firms or their services.

The development of the proposed standards has been influenced by concerns about audit quality, as indicated by the results of peer reviews and studies by other regulators, such as the following:

¹ All QC and AU-C sections can be found in AICPA *Professional Standards*.

- Risks to audit quality correlated with audits, reviews, and attestation engagements performed by engagement partners who perform a low volume of such engagements
- Consistency issues in the performance of engagements and a lack of focus on planning
- Over-reliance on intellectual resources, such as third-party quality control materials, that are not sufficiently tailored to the nature and circumstances of the firm
- Challenges experienced by smaller firms in applying the standards
- A need to improve firm governance and leadership and the culture and tone at the top of the firm

The ASB has been monitoring efforts to enhance assurance engagement quality, including those by the AICPA Enhancing Audit Quality initiative. In particular, the ASB has been following the IAASB's project on its quality management standards. The ASB provided input at every stage of the development of the IAASB standards through the involvement of U.S. participants on the IAASB task forces and feedback to the IAASB throughout its process of drafting the proposed standards.

IAASB Quality Management Project

In December 2020, the IAASB issued new standards relating to quality management at both the firm and audit engagement level (hereinafter referred to as the *IAASB Quality Management Standards*), comprising the following:

- International Standard on Quality Management (ISQM) 1 (Previously International Standard on Quality Control 1), *Quality Management for Firms That Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*
- ISQM 2, *Engagement Quality Reviews*
- International Standard on Auditing (ISA) 220 (Revised), *Quality Management for an Audit of Financial Statements*

The IAASB determined the need to develop and revise these standards through a number of information-gathering and outreach activities undertaken over the course of many years dating back to 2013. These activities highlighted a number of critical issues including the following:

- A need to improve firm governance and leadership and the culture and tone at the top of the firm
- Addressing the emergence of new trends, for example, how firms today communicate with stakeholders
- Dealing with concerns about firms placing undue reliance on services or resources from their networks and network firms
- Challenges experienced by smaller firms in applying the standards

- Strengthening the engagement partner’s responsibilities
- Improving the robustness of a number of aspects of engagement quality control reviews

In addition to submitting a comment letter on the IAASB exposure draft, the ASB provided input to the development of the IAASB standards through the involvement of U.S. participants on the IAASB task forces and feedback to the IAASB at each stage of drafting the proposed standards.

PCAOB Quality Control Project

On December 17, 2019, the PCAOB issued a concept release entitled *Potential Approach to Revisions to PCAOB Quality Control Standards*. The concept release outlines that the PCAOB is considering an approach that would use proposed ISQM 1 as a starting point. The PCAOB stated that

Information gathered through our oversight, outreach, and research activities persuades us that our QC standard should be built on an integrated risk-based framework, as Proposed ISQM 1 is. In addition, many firms that follow PCAOB standards are also subject to other QC standards (including the IAASB’s and the AICPA’s standards), so they are required to implement QC systems that comply with both PCAOB standards and those other standards. *Due to the foundational nature of QC systems, we believe that it would not be practical to require firms to comply with fundamentally different QC standards.* (emphasis added).

The comment period for the concept release ended on March 16, 2019. There were 36 respondents as of May 11, 2020. Most respondents commented that they are supportive of a potential quality control standard that is principles-based and scalable with *minimal incremental requirements to proposed ISQM 1*. (emphasis added).

Convergence

It is the ASB’s strategy to converge its standards with those of the IAASB, while taking into consideration the standards of other standard-setters. The ASB believes that it is particularly important to converge with the quality management standards of the IAASB because the issues that led the IAASB to revise its standards are of equally critical importance in the United States. In addition, the ASB believes that it is in the public interest to converge with the risk-based approach of the IAASB quality management standards for the following reasons:

- The public interest is served by the consistent performance of quality audit and attestation engagements, and a quality management system is foundational to that consistent quality performance. This quality management foundation is not fundamentally different for users of assurance reports in the United States than for users in other countries, nor is it different based on the nature of the entity subject to the engagement.
- A quality management standard promulgated by the ASB that is foundationally different from that promulgated by the IAASB or PCAOB could be perceived as being of lower quality, as could, by extension, engagements performed by firms applying such a different standard.

- For firms that perform engagements in accordance with the standards of the ASB, the IAASB or the PCAOB, complying with fundamentally different quality management standards is not feasible, and performing an audit in accordance with multiple sets of auditing and quality management standards (for example, those of the ASB and the IAASB or the ASB and the PCAOB) would be exponentially impracticable.

In converging with the standards of the IAASB, the ASB uses the corresponding IAASB standard as the base in developing its standards. In making the proposed revisions to the accompanying proposed QM standards, the ASB used ISQM 1, ISQM 2, and ISA 220 (Revised), respectively, as the base.

In converging, the ASB has used the terms *quality management* and *engagement quality review*, instead of the terms *quality control* and *engagement quality control review*, respectively, used in its current standards. In addition, “Statements on Quality Control Standards” have been retitled “Statements on Quality Management Standards.” These changes were made to reflect the new quality management approach proposed for the firm’s system of quality management in proposed SQMS No. 1, as described in the “Fundamental Aspects of the Proposed Standards” section that follows.

The ASB has made certain changes to the language of the IAASB standards to use terms or phrases that are more common in the United States and to tailor examples and guidance to the U.S. environment. However, the ASB believes that such changes will not create substantive differences in application between the IAASB Quality Management Standards and the proposed QM standards.

Fundamental Aspects of the Proposed Standards

Proposed SQMS No. 1

A New Approach Focused on Quality Management

The proposed standard takes a new approach that emphasizes the responsibility of firm leadership for proactively managing quality, while at the same time being scalable to deal with differences in the size of firms and nature of the services they provide. The essence of the new approach is to focus firms’ attention on risks that may have an impact on engagement quality. Unlike extant QC section 10, the new approach requires a firm to customize the design, implementation, and operation of its system of quality management based on the nature and circumstances of the firm and the engagements it performs. The new approach also requires the firm to transition from policies and procedures that address standalone elements, as required by extant QC section 10, to an integrated and iterative approach that reflects upon the system as a whole. The proposed standard takes a proactive approach to quality management, with an increased emphasis on a continual flow of remediation and improvement.

The Components of the System of Quality Management

A system of quality management addresses the following eight components:

1. The firm's risk assessment process (new)
2. Governance and leadership (adapted from the leadership responsibilities for quality within the firm component in QC section 10)
3. Relevant ethical requirements (same name as component in QC section 10)
4. Acceptance and continuance of client relationships and specific engagements (same name as component in QC section 10)
5. Engagement performance (same name as component in QC section 10)
6. Resources (adapted from the human resources component in QC section 10)
7. Information and communication (new)
8. The monitoring and remediation process (adapted from the monitoring component in QC section 10)

As indicated by illustration 1, the components are highly integrated and do not operate in a linear manner. The new components, and significant changes to existing components, are discussed in more detail as follows.

Illustration 1:

The components of the system of quality



Objective of the Proposed Standard

The objective of the proposed standard is similar to the objective in extant QC section 10 and includes both the *objective of the firm* and the *objective of the system of quality management*.

The *objective of the firm* in the context of the standard is to design, implement, and operate a system of quality management that provides the firm with reasonable assurance that the *objectives of the system of quality management* are achieved. The system of quality management is designed to achieve the following two objectives:

- a. The firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements.
- b. Engagement reports issued by the firm are appropriate in the circumstances.

An effective system of quality management provides the firm with reasonable assurance regarding the achievement of the two objectives. In this context, reasonable assurance is not intended to be obtained through independent assurance that the system is effective (that is, for example, by having a peer review every year). Instead, reasonable assurance is obtained through the operation of the system as a whole.

The objective of proposed SQMS 1



Risk Assessment Process

As mentioned previously, proposed SQMS No. 1 includes a new approach that focuses firms’ attention on risks that may have an impact on engagement quality. The firm’s risk assessment process is a new component that comprises the process the firm is required to follow in implementing the risk-based approach to quality management.

The risk assessment is a three-step process:

1. *Establish quality objectives.* The proposed standard requires the firm to establish

specific quality objectives for each component except monitoring and remediation. The firm is required to establish additional quality objectives when necessary to achieve the objective of the system of quality management; however, based on the nature and circumstances of the firm and its engagements, the firm may not find it necessary to establish additional quality objectives.

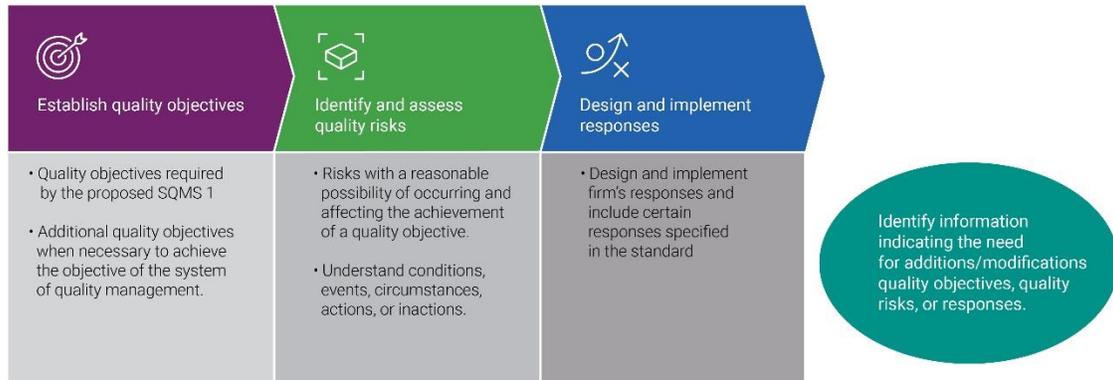
2. *Identify and assess risks to the achievement of the quality objectives* (referred to in the proposed standard as *quality risks*). Identifying and assessing quality risks involves
 - a. understanding the factors (that is, the conditions, events, circumstances, actions, or inactions) that may adversely affect the achievement of the quality objectives, and
 - b. identifying and assessing the quality risks by taking into account how and the degree to which the factors may adversely affect the achievement of the quality objectives. (The assessment of identified quality risks does not require formal ratings or scores.)

A risk arises from how, and the degree to which, a condition, event, circumstance, action, or inaction may adversely affect the achievement of a quality objective. Not all risks meet the definition of a *quality risk*. Professional judgment assists the firm in determining whether a risk is a quality risk, which is based on the firm's consideration of whether there is a reasonable possibility of the risk occurring, and individually, or in combination with other risks, adversely affecting the achievement of one or more quality objectives. The firm takes into consideration how frequently the quality risk is expected to occur and how much time it would take for the quality risk to have an effect and whether in that time the firm would have an opportunity to respond to mitigate the effect of the quality risk.

3. *Design and implement responses to address the quality risks*. The nature, timing, and extent of the firm's responses to address the quality risks are based on, and responsive to, the reasons for the assessments given to the quality risks. Certain responses are specified in the standard; however, the specific responses required by the standard will not be sufficient for the firm to address all its quality risks.

Firms are also required to identify information indicating the need for additions or modifications to quality objectives, quality risks, or responses.

The risk assessment process



Governance and Leadership

A firm's governance and leadership are of paramount importance to engagement quality because that's how the firm establishes its culture and ethics, self-regulates, and serves as the framework for how the firm's decisions are made. Proposed SQMS No. 1 provides substantial enhancements to improve the robustness of firms' governance and leadership. In particular, it addresses the expected behavior of firm leadership in setting the tone at the top, the appropriate qualifications of leadership, and holding leadership accountable through performance evaluations. The standard also now addresses the importance of quality in the firm's strategic decisions and actions, including financial and operational priorities, as well as firm leadership's ability to influence decisions about the firm's resources.

The firm is required to assign ultimate responsibility and accountability for the system of quality management to the firm's CEO, managing partner (or equivalent) or, if appropriate, managing board of partners (or equivalent). In addition, the firm is required to assign the following to designated individuals:

- Operational responsibility for the system of quality management
- Operational responsibility for specific aspects of the system of quality management, including compliance with independence requirements and the monitoring and remediation process

Resources

Extant QC section 10 addresses only human resources. Proposed SQMS No. 1 expands this to address all resources that the firm needs both to operate the system and to perform engagements. These resources cover

- technological resources, for example, audit tools or IT applications used by the firm for independence monitoring;
- intellectual resources, for example, the firm’s methodology, guidance, templates, or tools; and
- human resources, which may include people outside the firm used in engagements, including component auditors or engagement quality (EQ) reviewers who are external to the firm.

The proposed standard focuses on what resources are needed, how they are used and maintained, and whether they are appropriate. The principles-based nature of the requirements relating to resources take into account the variety of resources used and where they may come from and mitigate the risk that the standard doesn’t quickly become outdated because of changes in technology. Proposed SQMS No. 1 also covers the use of resources from service providers and how to determine that those resources are appropriate for the intended use by the firm. A resource from a service provider could be a methodology, an IT application or people used in an engagement. Services that come from a firm’s network, if the firm belongs to a network, are not considered as coming from a service provider (see the section “Network” that follows).

Information and Communication

Extant QC section 10 does not address the broader need for information and communication across the system and the communication of relevant, reliable information with engagement teams, which is essential for the effective operation of the system of quality management and the performance of engagements. It also does not acknowledge the two-way nature of communication. As a result, proposed SQMS No. 1 includes a new component, information, and communication.

The proposed standard underscores the importance of a continuous flow of information and communication by linking the exchange of information to the firm’s culture, so that it is driven from top leadership throughout the firm. The standard requires that the firm establish an information system with processes to identify, capture, process, and maintain information, acknowledging that less complex firms with fewer personnel and direct involvement of leadership may accomplish the objective with less rigorous or detailed policies and procedures.

Both internal and external communication are dealt with in the standard. From an internal perspective, it reinforces the need for robust two-way communication throughout the firm. From an external perspective, the standard reinforces a key public interest issue, which is encouraging firms to be transparent to external parties about their quality management systems in a relevant, innovative, and proactive manner. In order to drive the proactivity of communication, the standard requires firms to establish policies and procedures that address when communications with external parties are appropriate. This drives firms to think about what is appropriate in their

circumstances; for example, less complex firms with fewer personnel may conclude, after due consideration, that no external communication about their system of quality management is needed. Firms may communicate through various mechanisms. In order to promote continual innovation in this area, the proposed standard provides flexibility regarding the specific information communicated, the form of that communication, and the nature, timing, and extent of communication.

Monitoring and Remediation

Proposed SQMS No. 1 more robustly addresses monitoring activities and shifts the focus from engagement level monitoring to monitoring the entire system of quality management. The requirements promote more proactive and effective monitoring activities and have increased the emphasis on tailoring the monitoring activities to provide a sufficient basis for the firm to evaluate the system. The new requirements have been designed to emphasize factors that the firm would consider in designing its monitoring activities, rather than prescribing all the monitoring activities that need to be performed. The nature, timing, and extent of monitoring activities will be driven by a number of factors at the firm, including the following:

- How the underlying system is designed
- The nature and circumstances of the firms and engagements it performs
- The extent of changes to the system
- The results of previous monitoring activities or external inspections

The standard includes a requirement to inspect completed engagements and for engagement partners to be inspected on a cyclical basis. The firm determines its inspection criteria, including how often to select completed engagements, which completed engagements to select, which engagement partners to select, and how frequently to select an engagement partner, taking into account factors such as other types of monitoring the firm does, areas of risk, and how the system is designed. See Issue 1 in the “Issues for Consideration” section that follows for further discussion of inspection of completed engagements.

The proposed standard includes requirements for evaluating findings and identifying deficiencies, and evaluating the severity and persuasiveness of the deficiencies. These include a new requirement to investigate the root cause of identified deficiencies. The requirement is intended to be flexible to encourage firms to scale the nature, timing, and extent of the procedures to investigate the root cause of the deficiencies so that they are appropriate and tailored to the circumstances. The evaluation of the severity and pervasiveness of deficiencies is also used by leadership in evaluating the system and concluding whether it achieved its objectives. (The AICPA staff will consider the need for implementation guidance that will assist firms and peer reviewers to have a mutual and consistent understanding of the evaluation of deficiencies).

A number of improvements were also made to address remediation, including requirements of leadership to assure that remedial actions have been implemented and are effective.

Networks

A firm may belong to a network, which may establish requirements regarding the firm's system of quality management or may make services (including resources) available that the firm may choose to implement or use in the design, implementation, and operation of its system of quality management. For example, a firm may be subject to common policies or procedures established by the network, and the network may hold the firm accountable for complying with such policies or procedures. A network may also provide services to the firm such as IT applications or a methodology or monitoring activities. Such requirements or services may be intended to promote the consistent performance of quality engagements across the firms that belong to the network. However, concerns have been raised that firms place undue reliance on network requirements or network services without sufficient consideration of whether the requirements or services are appropriate and suitable for the nature and circumstances of the firm. The firm is solely responsible for its own system of quality management; a network is not responsible for the firm's system.

Proposed SQMS No. 1 requires that if a firm is subject to network requirements or uses network services, the firm should understand how those requirements or services fit into the firm's system of quality management and determine whether the requirement or service needs to be adapted or supplemented to be appropriate for use in the firm's system of quality management. The proposed standard addresses monitoring activities undertaken by the network and requires the firm to determine the effect of network-level monitoring activities on the firm's monitoring activities. The firm is also required to understand the overall scope of the monitoring activities undertaken by the network across the network firms, including monitoring activities to determine that network requirements have been appropriately implemented across the network firms and to obtain information annually about the results of the network's monitoring activities. This is intended to drive improvements at the network level because firms will need networks to provide more information than they may be providing now.

Request for comment:

1. Respondents are asked to provide their views on the preceding changes. In addition, the ASB is seeking respondents' views on whether the requirements in proposed SQMS No. 1 are clear and understandable and whether the application material is helpful in supporting the application of those requirements.

Scalability

The new quality management approach drives a firm to think about the nature and circumstances of the firm and the engagements it performs in designing, implementing, and operating its system of quality management, and the approach is focused on achieving quality objectives that are outcome-based. Although this approach is expected to generate multiple benefits for engagement quality, one of the most important benefits is a tailored system of quality management that is

suitable for the nature and circumstances of the firm and the engagements it performs. Thus, this approach is inherently scalable for firms of different sizes and complexity.

The quality management approach in proposed SQMS No. 1 is more complex than the approach in extant QC section 10 and has added to the overall length of the standard. However, the ASB is of the view that the approach in extant QC section 10 is no longer fit for purpose and adaptable to the changing environment, given that it is more prescriptive in nature, and does not promote a scalable and tailored system of quality management that focuses on areas of risk. The ASB acknowledges that firms will need to invest time and resources to implement the revised standard initially; however, it is of the view that over time a more tailored and focused system of quality management will result in more effective use of firm resources and improvements in engagement quality.

The ASB intends to make nonauthoritative guidance available when the final standards are issued to help firms implement and apply the new quality management standards.

Request for comment:

2. Respondents are asked to provide their views on the scalability of the new quality management approach. In addition, the ASB is seeking respondents' views on specific requirements in proposed SQMS No. 1 that may inhibit scalability and requirements for which additional application material regarding scalability would be helpful.

Proposed SQMS No. 2

Relationship Between Proposed SQMS No. 2 and Proposed SQMS No. 1

Proposed SQMS No. 1 addresses the firm's responsibility for establishing a system of quality management, including the new quality management approach. An engagement quality review is a response, among others, that is designed and implemented by a firm to address quality risks. Although the performance of an engagement quality review is undertaken at the engagement level, it is a response that is implemented by the engagement quality reviewer on behalf of the firm.

Proposed SQMS No. 1 requires that the firm determine when an engagement quality review is an appropriate response to quality risks. Proposed SQMS No. 2 contains requirements for policies and procedures addressing the appointment and eligibility of engagement quality reviewers and performance of engagement quality reviews. Although there will no longer be requirements for the performance of engagement quality reviews in AU-C section 220, the proposed QM SAS contains requirements regarding the engagement partner's responsibilities relating to the engagement quality review, which largely focus on how the engagement partner and the engagement team interact with the engagement quality reviewer.

Why a Separate Standard?

The requirements for engagement quality reviews currently reside in extant QC section 10² and AU-C section 220.³ Having a separate standard for engagement quality reviews is expected to provide a number of benefits, including the following:

- Clarifying that an engagement quality review can be a response to quality risks for any type of engagement, not only audit engagements
- Placing emphasis on the importance of the engagement quality review
- Facilitating the enhancement of the robustness of the requirements for the eligibility of engagement quality reviewers and the performance and documentation of the review
- Providing a mechanism to more clearly differentiate the responsibilities of the firm and the engagement quality reviewer
- Increasing the scalability of proposed SQMS No. 1 by not including requirements that would be irrelevant in circumstances when a firm determines that there are no engagements for which an engagement quality review is an appropriate response to address the quality risks

Objective of the Standard

Proposed SQMS No. 2 addresses the responsibilities of multiple parties, that is, the firm and the engagement quality reviewer. However, because the engagement quality reviewer is acting on behalf of the firm, the objective of the standard has been framed as the objective of the firm.

The objectives of the ASB's standards are intended to be outcome-oriented (that is, the desired outcome of applying the requirements in the standard and not an "executive summary" of those requirements). Accordingly, the objective of proposed SQMS No. 2 reflects the intended outcome, which is the performance of an engagement quality review.

Appointment and Eligibility of Reviewers

The proposals in proposed SQMS No. 2 and the aspects of proposed SQMS No. 1⁴ regarding engagement quality reviews are made with the public interest in the forefront. Certain stakeholders, such as regulators, believe that an engagement quality review is a strong response to quality risks that is in the public interest. Engagement quality reviews support the exercise of professional skepticism at the engagement level by providing an objective evaluation of

² Paragraphs .38–.48 of QC section 10, *A Firm's System of Quality Control*.

³ Paragraphs .21–.22 of AU-C section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

⁴ Paragraph .35f and related application material in proposed Statement on Quality Management Standards (SQMS) No. 1, *A Firm's System of Quality Management* (proposed SQMS No. 1), address engagement quality reviews.

engagement teams' significant judgments made in performing an engagement. The requirements in proposed SQMS No. 2 for the appointment and eligibility of the engagement quality reviewer (whether internal to the firm or external) are more robust than those in extant QC section 10. Requirements and application material have been added to address the following:

- The eligibility of the individuals within the firm responsible for the appointment of engagement quality reviewers
- The eligibility of individuals to assist the engagement quality reviewer in performing the engagement quality review
- The authority, competence, and capabilities, including sufficient time to perform the engagement quality review, of the engagement quality reviewer
- The engagement quality reviewer taking responsibility for the performance of the engagement quality review, including that the work of individuals assisting in the review is appropriate

The requirements also address compliance with relevant ethical requirements, including that threats to objectivity of the engagement quality reviewer are eliminated or reduced to an acceptable level. To reduce threats to objectivity to an acceptable level, proposed SQMS No. 2 requires firm policies or procedures to include limitations on the eligibility of an individual to be appointed as engagement quality reviewer for an engagement on which the individual previously served as engagement partner. This limitation is necessary to make sure that the engagement quality reviewer is in a position to objectively evaluate and, where appropriate, challenge the significant judgments made and the exercise of professional skepticism by the engagement team. See Issue 2 in the "Issues for Consideration" section that follows for further discussion.

Performance and Documentation of the EQ Review

Significant Judgments and Significant Matters

The requirements for the performance of the engagement quality review focus the engagement quality reviewer's attention on significant judgments and significant matters. The proposed standard includes a stand-back requirement for the engagement quality reviewer to determine whether the performance requirements of the proposed SQMS with respect to the performance of the engagement quality review have been fulfilled. Once the engagement quality reviewer has made this determination, the engagement quality reviewer is required to inform the engagement partner that the engagement quality review is complete. The engagement partner is precluded from dating the engagement report before receiving notification from the engagement quality reviewer that the engagement quality review is complete.

Timing of the Review

An effective engagement quality review is achieved when the engagement quality reviewer is involved at appropriate points in the engagement, consistent with when significant judgments are being made by the engagement team because doing so facilitates the resolution of issues in a

timely manner. Accordingly, proposed SQMS No. 2 includes a new requirement addressing the engagement quality reviewer's responsibility to perform the procedures at appropriate points in time during the engagement.

Documentation

Proposed SQMS No. 2 includes a specific requirement for the engagement quality reviewer to take responsibility for documentation of the engagement quality review and adds a requirement that the documentation be filed with the engagement documentation. The proposed standard also includes an overarching requirement for the documentation to be sufficient to enable an experienced practitioner, having no previous connection to the engagement, to understand the nature, timing, and extent of the engagement quality review procedures performed.

Request for comment:

3. Respondents are asked to provide their views on the preceding changes. In addition, the ASB is seeking respondents' views on whether the requirements in proposed SQMS No. 2 are clear and understandable, and whether the application material is helpful in supporting the application of those requirements.

Proposed QM SAS

Overall Matters

The public interest is served by the consistent performance of quality engagements. The proposed QM SAS addresses public interest considerations by encouraging proactive management of quality at the engagement level, emphasizing the importance of the exercise of professional skepticism, enhancing the documentation of the auditor's judgments, and reinforcing the need for robust communications during the audit.

Proposed SQMS No. 1 addresses the system of quality management, which forms the foundation for the management of quality. Proposed QM SAS addresses how the engagement partner leverages the firm's system and manages quality at the engagement level. The proposed SAS makes clear that the engagement partner has overall responsibility for managing and achieving quality. This includes creating an environment that emphasizes the firm's culture and expected behavior of engagement team members. These behaviors include the responsibility of all engagement team members for quality; the importance of professional ethics, values, and attitudes; and the importance of professional skepticism to a quality audit.

The engagement partner remains ultimately responsible and, therefore, accountable, for compliance with the requirements of the proposed SAS. The phrase *take responsibility for...* is used for those requirements for which the engagement partner is permitted to assign the design

or performance of procedures, tasks, or actions to appropriately skilled or suitably experienced members of the engagement team. For other requirements, the proposed SAS expressly intends that the requirement or responsibility be fulfilled by the engagement partner. To fulfill the requirement, the engagement partner may obtain information from the firm or other members of the engagement team, (for example, information to make the required decision or judgment). For example, the engagement partner is required to determine that members of the engagement team collectively have the appropriate competence and capabilities to perform the audit engagement. To make a judgment on whether the competence and capabilities of the engagement team is appropriate, the engagement partner may need to use information compiled by the engagement team or from the firm's system of quality management.

Ordinarily, the engagement team may depend on the firm's policies or procedures in complying with the requirements of this proposed SAS, unless the engagement team's understanding or practical experience indicates that the firm's responses to quality risks are ineffective in context of the specific engagement or information provided by the firm or other parties indicates that the firm's policies or procedures are not operating effectively.

Engagement Partner's Overall Responsibility for Managing Quality on Audits, Including Engagement Performance and Stand Back

The engagement partner needs to be sufficiently and appropriately involved throughout the engagement as this is fundamental to providing the engagement leadership required to achieve high quality audits and, therefore, to meeting the objective of the QM SAS. The following diagram illustrates how the engagement partner's overall responsibility to manage and achieve quality on the engagement is demonstrated through sufficient and appropriate involvement throughout the engagement, such that the significant judgments made and the conclusions reached are appropriate given the nature and circumstances of the audit. This overall responsibility includes the following:

- a. **Fulfilling leadership responsibilities**, including taking actions to create an environment for the engagement that emphasizes the firm's culture and the expected behavior of engagement team members, and assigning procedures, tasks, or actions to other members of the engagement team
- b. **Supporting engagement performance**, including taking responsibility for the nature, timing, and extent of the direction, supervision, and review of the work performed
- c. A **"stand-back" requirement** to determine whether the engagement partner has taken overall responsibility for managing and achieving quality, including determining that the engagement partner's involvement has been sufficient and appropriate throughout the engagement and that the nature and circumstances of the engagement have been taken into account. Note that this is a new requirement.

The engagement partner's overall responsibility



Group Audit Engagements

In addition to firm personnel, engagement team members in a group audit engagement may include personnel who are external to the firm (for example, engagement team members who are from network firms or are service providers, such as component auditors from firms not within the firm's network). AU-C section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*, deals with special considerations that apply to an audit of group financial statements, including when component auditors are involved. Application guidance in the proposed QM SAS states that the firm or engagement partner may take different actions with respect to component auditors or other personnel who are external to the firm than the actions applicable to firm personnel. Additionally, examples are included in application guidance in the proposed QM SAS of considerations that may be made when component auditors are members of the engagement team.⁵ Proposed conforming amendments to AU-C section 300, *Planning an Audit*, clarify in paragraph .09 that the audit plan should include a description of the nature, timing, and extent of the planned direction and supervision of engagement team members and the review of their work. This includes engagement team members who are external to the firm, such as component auditors.

Relevant Ethical Requirements

In addition to enhancing the extant requirements, the proposed QM SAS includes requirements regarding the following:

⁵ See paragraphs A24, A25, A38, A54, A60, A76, A80, A91, A92, and A107 of proposed QM SAS.

- Understanding of the relevant ethical requirements and whether other members of the engagement team are aware of those requirements and the firm’s related policies or procedures
- Threats to compliance with relevant ethical requirements
- Determining whether relevant ethical requirements, including those related to independence, have been fulfilled

It also includes new application material that links with the firm-level requirements in proposed SQMS No. 1, describes possible appropriate actions if noncompliance is indicated, and links to the requirement in AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*,⁶ for the auditor’s report to include a statement regarding the auditor’s independence.

Engagement Resources

The engagement partner is required to take responsibility for the direction and supervision of the engagement team and review of their work. This includes tailoring the nature, timing, and extent of this responsibility to the nature and circumstances of the engagement and the resources — technological, intellectual, and human — assigned to the engagement. If the resources are insufficient or inappropriate, the engagement partner is required to take appropriate action.

Other New Requirements

The proposed SAS clarifies what the engagement partner needs to review, which are significant matters and significant judgments, and formal written communications to management and those charged with governance.

Request for comment:

4. Respondents are asked to provide their views on the preceding changes. In addition, the ASB is seeking respondents’ views on whether the requirements in the proposed QM SAS are clear and understandable, and whether the application material is helpful in supporting the application of those requirements.

Proposed Amendments to Existing Standards

Amendments to various AU-C and AT-C sections for consistency with the proposed QM standards are proposed as shown in the appendix to this exposure draft. Amendments to standards applicable to review and compilation engagements will be considered by the Accounting and Review Services Committee.

⁶ Paragraph .28c of AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*.

Effective Date

- Proposed SQMS No. 1:

Systems of quality management in compliance with proposed SQMS No. 1 would be required to be designed and implemented by December 15, 2023, and the evaluation of the system of quality management required by proposed SQMS No. 1⁷ would be required to be performed within one year following December 15, 2023.

- Proposed SQMS No. 2:

Proposed SQMS No. 2 would be effective for

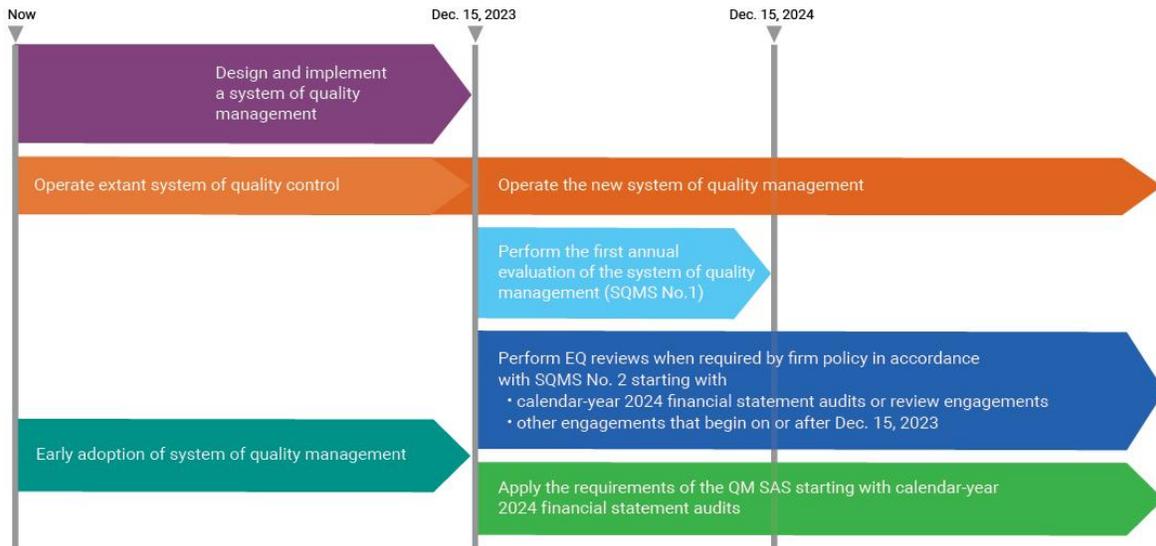
- a. audits or reviews of financial statements for periods beginning on or after December 15, 2023, and
 - b. other engagements in the firm's accounting and auditing practice beginning on or after December 15, 2023. An engagement in the firm's accounting and auditing practice begins when an engagement letter or other agreement to perform attest services is signed, or when the firm begins to perform the engagement, whichever is earlier.⁸
- The proposed QM SAS would be effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2023.

The following illustrates the timeline using the proposed effective dates:

⁷ See paragraphs 54–55 of proposed SQMS No. 1.

⁸ See ET section 0.400.39 of the AICPA Code of Professional Conduct. All ET sections can be found in AICPA *Professional Standards*.

Timeline of proposed effective dates



Between now and December 15, 2023:

- Design and implement the system of quality management so that the system of quality management is fully operational on December 15, 2023

On and after December 15, 2023:

- Operate under the system of quality management.
- If an engagement quality review is required by firm policies for an engagement, perform engagement quality reviews in accordance with proposed SQMS No. 2 starting with
 - calendar-year 2024 financial statement audits or review engagements.
 - Other engagements that begin on or after December 15, 2023.
- Apply the requirements of the QM SAS starting with calendar-year 2024 financial statement audits.

By December 15, 2024:

- Perform the first annual evaluation of the system of quality management

These effective dates are provisional but would not be earlier than December 15, 2023. The ASB intends to provide a period of no less than 18 months between the issuance of the proposed quality management standards and their effective dates. The ASB recognizes that most firms will need implementation guidance materials for effective implementation and that such materials may not be available immediately upon issuance of the final standards.

Proposed SQMS No. 1 would need to be fully implemented by its effective date; that is, on December 15, 2023, the new system of quality management needs to be operational. The ASB is

aware that both SAS No. 143, *Auditing Accounting Estimates and Related Disclosures*, and the proposed risk assessment standard (proposed SAS *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*) will be or are proposed to be, respectively, effective for audits of financial statements for periods ending on or after December 15, 2023, essentially the same effective date as the proposed QM SAS and SQMS No. 2. The proposed quality management standards are intended to enhance the quality of assurance engagements and, accordingly, it is in the public interest for them to be effective as soon as is practicable. However, too short an implementation period may exacerbate risks to quality, lead to increased peer review findings, and would be inconsistent with the objectives of the project to enhance the ASB's quality management standards.

Request for comment:

5. Respondents are asked to provide their views on whether the effective dates are clear.
6. Respondents are asked to provide their views on whether an 18-month implementation period is appropriate. If that period is not appropriate, please explain why and what implementation period would be appropriate.

Issues for Consideration

In addition to overall views on the proposed changes to existing standards and the amendments described previously, the ASB is requesting feedback from respondents on the following issues:

Issue 1 — Self-Inspection

An existing difference between International Statement on Quality Control (ISQC) 1, *Quality Control for Firms That Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*, and QC section 10 relates to the involvement of those performing the engagement or the engagement quality review in inspecting the engagements (also referred to as *self-inspection*). Both ISQC 1 (par. 48) and ISQM 1 (par. 46) require firms to include the inspection of completed engagements in its monitoring activities and prohibit engagement team members or the engagement quality reviewer of an engagement from performing any inspection of that engagement.

QC section 10 does not include this prohibition (see par. .52c). The ASB had previously concluded that it was not necessary to change existing practice to converge with ISQC 1 because in the United States, the peer review process provides a safeguard and provides evidence that monitoring procedures involving self-inspection can be effective.

Application material in extant ISQC 1 states the following:

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.

Application material in ISQM 1 is more principles-based and addresses the self-review threat:

A171. The provisions of relevant ethical requirements are relevant in designing the policies or procedures addressing the objectivity of the individuals performing the monitoring activities. A self-review threat may arise when an individual who performs:

- An inspection of an engagement was:
 - In the case of an audit of financial statements, an engagement team member or the engagement quality reviewer of that engagement or an engagement for a subsequent financial period; or
 - For all other engagements, an engagement team member or the engagement quality reviewer of that engagement.
- Another type of monitoring activity had participated in designing, executing or operating the response being monitored.

Application material in QC section 10 states the following:

Considerations Specific to Smaller Firms

A72. In small firms with a limited number of persons with sufficient and appropriate experience and authority in the firm, monitoring procedures may need to be performed by some of the same individuals who are responsible for compliance with the firm's quality control policies and procedures. This includes review of engagement working papers, reports, and clients' financial statements by the engagement partner or other qualified personnel after the report release date. To effectively monitor one's own compliance with the firm's policies and procedures, it is necessary that an individual be able to critically review his or her own performance, assess his or her own strengths and weaknesses, and maintain an attitude of continual improvement. Changes in conditions and the environment within the firm (such as obtaining clients in an industry not previously serviced or significantly changing the size of the firm) may indicate the need to have quality control policies and procedures monitored by another qualified individual.

A73. Having an individual inspect his or her own compliance with a quality control system may be less effective than having such compliance inspected by another qualified individual. When one individual inspects his or her own compliance, the firm has a higher risk that noncompliance with policies and procedures will not be detected. Accordingly, a firm with a limited number of persons with sufficient and appropriate experience and authority in the firm may find it beneficial to engage a suitably qualified external person or another firm to perform engagement inspections and other monitoring procedures.

In addition to considering the views of the members of the ASB and the Quality Standards Task Forces from firms of various sizes, the ASB reached out to the AICPA PCPS Technical Issues Committee, whose members are all from small firms.

Views considered by the ASB regarding having individuals inspect their own compliance with a system of quality management included the following:

- It can be difficult to find sufficiently experienced and knowledgeable external people, particularly for specialized industries or areas.
- Needing to hire separate external people to perform an engagement quality review, an inspection, and a peer review puts an expensive burden on the smallest firms.
- Inspection carries a cost to each firm. The larger firms may benefit from economies of scale, and their costs may be opportunity cost, rather than out-of-pocket, but there is a cost associated with the person performing the inspection.
- Potential safeguards against the self-review threat include internal training. Effective training addresses not only technical expertise (for example, specialized knowledge of employee benefit plans) but also training in the firm's system of quality management and how to be a critical objective reviewer.
- Self-inspection cannot identify one's own lack of knowledge. For example, inspection may uncover that the engagement partner, being unaware of recently effective standards, did not apply them to the engagement. But that engagement partner, inspecting their own work while being unaware of recently effective standards, would never identify that the standards were not appropriately applied in that engagement. Although subscribing to a third-party methodology might correct the deficiency of the firm's methodology of not being current on professional standards, it would not make self-inspection any more effective at identifying what one does not know.
- Extant QC section 10 states that peer review can substitute for inspection for the period covered by the peer reviews. However, the period covered by the peer review is only one year out of three. Proposed SQMS No. 1 requires that monitoring procedures be performed annually and requires an annual evaluation of the system of quality management.

Other than the peer review process, the ASB was unable to identify anything unique in the United States with regard to self-inspection, nor did the ASB believe that safeguards exist that could lower the self-review threat to an acceptable level. The ASB recognizes that the extant standard permits those involved in the engagement to inspect their own work, and some practitioners may be capable of doing so effectively. However, while concerned about the impact on smaller firms, the ASB believes that this requirement is necessary to enhance audit quality. Accordingly, proposed SQMS No. 1 convergences with the IAASB standards with respect to self-inspection.

Request for comments:

7. Respondents are asked whether they agree that inspection of completed engagements by those involved in the engagements should be precluded in order to enhance audit quality. If not, please explain why and provide examples of safeguards that could lower the self-review threat to an acceptable level.

Issue 2 — Cooling-Off Period for Engagement Quality Reviewers

The exposure draft of proposed ISQM 2, *Engagement Quality Reviews*, (ED-ISQM 2) presented the IAASB view that matters on which significant judgments are made in recurring engagements often do not vary and, therefore, significant judgments made in prior periods may continue to affect judgments of the engagement team in subsequent periods. Thus, the ability of an engagement quality reviewer to perform an objective evaluation of significant judgments is affected when the individual was previously involved with those judgments as the engagement partner. In such circumstances, it is important that appropriate safeguards are put in place to reduce threats to objectivity, in particular, the self-review threat, to an acceptable level. Accordingly, ED-ISQM 2 included a new requirement for the firm to establish policies or procedures that include limitations on the eligibility of an individual to be appointed as engagement quality reviewer for an engagement on which the individual previously served as the engagement partner. Furthermore, the application material in ED-ISQM 2 suggested such limitations may be accomplished by establishing a cooling-off period and noted that determining a suitable cooling-off period depends upon the facts and circumstances of the engagement and applicable provisions of law or regulation and relevant ethical requirements. The application material further noted that, for an audit of a listed entity, it is unlikely that an engagement partner would be able to serve as the engagement quality reviewer until two subsequent audits have been conducted. The IAASB believed this application material recognized that audits of listed entities generally involve more complex judgments by engagement teams and that a cooling-off period would be in the public interest.

The IAASB exposure draft asked for views on the need for additional guidance regarding a cooling-off period. Seventy percent of the 91 respondents agreed on the need for guidance; about 17 percent (16 of 91) of respondents (including two IAASB Monitoring Group members) commented that there should be a requirement for a specific cooling-off period for an individual stepping into the role of engagement quality reviewer after serving as engagement partner.

The IAASB decided, for the final standard, to require a cooling-off period because it believed it to be the only safeguard to the self-review threat to objectivity, given the importance of maintaining objectivity in performing an objective evaluation of the significant judgments made by the engagement team. This requirement applies to all engagements for which an engagement quality review is performed. In reaching this conclusion, the IAASB noted that other than for audits of listed entities or when required by law or regulation, engagement quality reviews are

not mandated for other engagements, and the firm may employ responses other than an engagement quality review to address quality risks. However, when an engagement quality review is required or has been determined by the firm to be the appropriate response, then the same requirements should apply in all cases because the threats to the objectivity of the engagement partner stepping into the role of an engagement quality reviewer are not unique to certain types of engagements or to audits of listed entities. The IAASB indicated that a conditional requirement would create a perception of different levels of engagement quality review for different types of engagements, which could lead to inconsistent application in practice and potential confusion in the minds of stakeholders and, therefore, would not be in the public interest. By extension, this also applies to any variation in the length of the cooling-off period for different types of engagements. Because the IAASB had suggested a two-year cooling-off period in the exposure draft, that was the length of the cooling-off period required by the final standard.

The PCAOB standards also require a two-year cooling-off period before a former engagement partner can serve as the engagement quality reviewer. However, the PCAOB exempts firms with fewer than 5 issuer audit clients and fewer than 10 partners from cooling-off periods for engagement quality reviews provided that they are inspected at least once every 3 years (AS 1220, *Engagement Quality Review*, paragraph .08).

The ASB considered the following three options:

1. No cooling-off period, with application guidance similar to that exposed by the IAASB in the exposure draft of ISQM 2
 - ASB members expressed concern that, combined with the requirement prohibiting self-inspection, requiring a cooling-off period would mean that some firms would need one person performing the inspection and another person performing the engagement quality review. Specifically, the conversation focused on the fact that this requirement might disproportionately affect smaller firms. Firms may not be able to identify qualified people, and this might result in fewer engagement quality reviews being performed, which would be an unintended negative consequence.
 - ASB members noted that no research exists to support the supposition that a cooling-off period improves audit quality.
 - ASB members also noted that unlike the International Ethics Standards Board for Accountants (IESBA) Code of Ethics for Professional Accountants (IESBA code), the AICPA Code of Professional Conduct does not require any cooling-off periods.
 - The ASB noted the following with regard to PCAOB requirements:
 - If the PCAOB provides an exemption from the cooling-off period in certain situations or circumstances, it seems overly prescriptive to require a cooling-off period for every engagement quality review performed on nonissuer engagements.

- On the other hand, the PCAOB Auditing Standards require an engagement quality review for every audit and attestation examination engagement. Many, if not most, engagements performed by small firms for issuer audit clients might not meet the firm’s criteria for an engagement quality review performed as a response to an assessed quality risk (other than being an issuer). However, an engagement quality review might be an appropriate response for engagements performed by the same firm for a nonissuer audit client.
2. Required cooling-off period of one year, with application material addressing when a longer period may be appropriate
- The ASB did not identify any differences in the United States that would affect a firm’s determination of whether an engagement quality review is an appropriate response to an assessed quality risk, nor identify other safeguards against the self-review or familiarity threat.
 - Because the vast majority of audits are for annual periods, one year may be an appropriate minimum cooling-off period.

The ASB considered the following application material to accompany a requirement for a one-year cooling-off period addressing when a longer period may be appropriate:

A17. Determining whether a cooling-off period of more than one year is appropriate to address familiarity and self-review threats depends upon the facts and circumstances of the engagement and engagement partner and may include the following considerations:

- The degree to which the following vary between periods in which the individual was the engagement partner:
 - Changes in the matters on which significant judgments are made
 - The facts and circumstances around those significant judgments

For example, if a business combination with a material effect on the financial statements has occurred, the significant judgments made in the current period may vary from those of the prior period to such an extent that an objective evaluation of those judgments could be made by the individual who served as the engagement partner in the previous period. Conversely, if comparative financial statements are presented, in the absence of other appropriate safeguards, an engagement partner might not be able to act as the engagement quality reviewer until no period in which the individual served as engagement partner is presented.

- A threat to the engagement partner’s objectivity when serving as the engagement quality reviewer may exist if the firm’s system of quality management penalizes engagement partners if deficiencies are found in their engagements.

3. Required cooling-off period of two years

- This results in full convergence with the IAASB standard, consistent with the ASB’s strategy. The ASB was unable to identify any differences in the United States that would affect a firm’s determination of whether an engagement quality review is an appropriate response to an assessed quality risk.
- The IESBA code requires partner and engagement quality reviewer rotation and cooling-off periods for engagements for public interest entities. Nonetheless, the IAASB required a two-year cooling-off period for all engagements when an engagement quality review has been determined by the firm to be the appropriate response, regardless of the type of entity.
- If a cooling-off period is required, any potential issues of identifying eligible engagement quality reviewers for a period of two years, instead of one year, do not seem to be so burdensome as to warrant divergence.

The ASB decided to require a two-year cooling-off period, consistent with ISQM 2. The ASB is interested in respondents’ views on this issue.

Request for comments:

8. Respondents are asked for their views on whether a cooling-off period should be required before a former engagement partner can serve as an engagement quality reviewer on that engagement, and (a) if so, the appropriate length of the required cooling-off period, or (b) if not, please explain why and provide examples of safeguards that could lower the objectivity threat to an acceptable level.

Issue 3 — Completion of Engagement Quality Review and Dating of the Auditor’s Report

Paragraph .41 of QC section 10, and paragraph .21 of AU-C section 220, require that when an engagement quality control review is performed, the engagement quality control review is completed before the report is released. The exhibit to QC section 10 and AU-C Appendix B, “Substantive Differences Between the International Standards on Auditing and Generally Accepted Auditing Standards,” both state that “... an engagement quality control review is an independent review of the engagement team’s significant judgments, including the date selected by the engagement team to date the report. As noted in the application material to QC section 10, when the engagement quality control review results in additional procedures having to be performed, the date of the report would be changed.”

Paragraph 21*b* of ISQM 2 requires that the firm’s policies or procedures preclude the engagement partner from dating the engagement report until the completion of the engagement quality review. Paragraph 36*d* of ISA 220 (Revised) requires that the engagement quality review be completed before the report is dated. In developing the proposed QM standards, the ASB discussed the existing divergence between generally accepted auditing standards and the ISAs regarding report dating. The ASB did not identify any differences between the United States and other jurisdictions that would warrant continued divergence from requiring that the engagement

quality review be completed before the report is dated. The ASB also noted that in practice it has become common for the report date and the report release date to coincide. Accordingly, paragraph 24*b* of proposed SQMS No. 2 and paragraph 36*d* of the proposed QM SAS are consistent with the equivalent paragraphs in the IAASB Quality Management Standards.

Request for comments:

9. Respondents are asked for their views on whether the engagement quality review should be required to be completed before the report is dated, rather than before the report is released.

Guide for Respondents

Respondents are asked to provide comments on the preceding issues as well as the changes to the proposed QM standards. Respondents are welcome to limit their comments to the aspects of the proposed QM standards of most interest to them and need not answer all questions posed in this exposure draft.

Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments and, where appropriate, make specific suggestions for any proposed changes. When a respondent agrees with proposals in the exposure draft, it will be helpful for the ASB to be made aware of this view, as well.

Written comments on the exposure draft will become part of the public record of the AICPA and will be available on the AICPA's website after August 31, 2021, until a final standard is issued. Responses should be sent to commentletters@aicpa-cima.com and received by August 31, 2021. Responses may be submitted in Word format or directly in the body of the email with an appropriate signature (name, firm). Unless the respondent explicitly permits otherwise, emailed comments will be posted without the sender's email address. Respondents may also submit a PDF version of their response for posting to the AICPA website.

Supplement to the Exposure Draft

To assist respondents in identifying changes and responding to this request to comment on the proposed QM standards, the Audit and Attest Standards staff has prepared documents that provide a detailed comparison of each proposed QM standard to the corresponding IAASB Quality Management standard. A detailed comparison of the proposed QM standards with the extant standards that they would supersede has not been prepared because the changes are too extensive for a paragraph-level comparison to be useful. However, the "Fundamental Aspects of the Proposed Standards" section includes a discussion of what is changing and the "Issues for Consideration" section includes issues related to specific changes from extant standards.

This staff-prepared supplementary material is available on the AICPA website at <https://www.aicpa.org/research/exposedrafts/accountingandauditing.html>. It is for informational purposes only and does not form part of the exposure draft; however, it may be useful for respondents in formulating comments.

Comment Period

The comment period for this exposure draft ends on August 31, 2021 (extended from June 11, 2021).

Auditing Standards Board

(2020–2021)

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Proposed Statement on Quality Management Standards

A Firm's System of Quality Management

Introduction

Scope of This Proposed Statement on Quality Management Standards

1. This proposed Statement on Quality Management Standards (SQMS) deals with a firm's responsibilities to design, implement, and operate a system of quality management for its accounting and auditing practice.
2. Engagement quality reviews form part of the firm's system of quality management and
 - a. this proposed SQMS addresses the firm's responsibility to establish policies or procedures addressing engagements that are required to be subject to engagement quality reviews.
 - b. proposed SQMS *Engagement Quality Reviews* deals with the appointment and eligibility of the engagement quality reviewer, and the performance and documentation of the engagement quality review.
3. Other professional standards include requirements for engagement partners and other engagement team members regarding quality management at the engagement level. For example, proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards* deals with the specific responsibilities of the auditor regarding quality management at the engagement level for an audit of financial statements and the related responsibilities of the engagement partner. (Ref: par. A1)
4. This proposed SQMS is to be read in conjunction with the AICPA Code of Professional Conduct (AICPA code) and other relevant ethical requirements. Law, regulation, or relevant ethical requirements may establish responsibilities for the firm's management of quality beyond those described in this proposed SQMS. (Ref: par. A2)
5. This proposed SQMS applies to audit and attestation engagements performed by CPA firms in accordance with *Government Auditing Standards*. This proposed SQMS does not apply to government audit organizations. Instead, those government audit organizations are subject to the quality control and assurance requirements of *Government Auditing Standards*.
6. This proposed SQMS applies to all firms that perform any engagement included in a firm's accounting and auditing practice. The system of quality management that is established in accordance with the requirements of this proposed SQMS enables the consistent performance by the firm of all such engagements.

The Firm's System of Quality Management

7. A system of quality management operates in a continual and iterative manner and is responsive to changes in the nature and circumstances of the firm and its engagements. It

also does not operate in a linear manner. However, for the purposes of this proposed SQMS, a system of quality management addresses the following eight components: (Ref: par. A3)

- a.* The firm's risk assessment process
 - b.* Governance and leadership
 - c.* Relevant ethical requirements
 - d.* Acceptance and continuance of client relationships and specific engagements
 - e.* Engagement performance
 - f.* Resources
 - g.* Information and communication
 - h.* The monitoring and remediation process
- 8.** This proposed SQMS requires the firm to apply a risk-based approach in designing, implementing, and operating the components of the system of quality management in an interconnected and coordinated manner such that the firm proactively manages the quality of engagements performed by the firm. (Ref: par. A4)
- 9.** The risk-based approach is embedded in the requirements of this proposed SQMS through the following:
 - a. Establishing quality objectives.* The quality objectives established by the firm consist of objectives in relation to the components of the system of quality management that are to be achieved by the firm. The firm is required to establish the quality objectives specified by this proposed SQMS and any additional quality objectives considered necessary by the firm to achieve the objectives of the system of quality management.
 - b. Identifying and assessing risks to the achievement of the quality objectives* (referred to in this standard as *quality risks*). The firm is required to identify and assess quality risks to provide a basis for the design and implementation of responses.
 - c. Designing and implementing responses to address the quality risks.* The nature, timing, and extent of the firm's responses to address the quality risks are based on, and responsive to, the reasons for the assessments given to the quality risks.
- 10.** This proposed SQMS requires that, at least annually, the individuals assigned ultimate responsibility and accountability for the system of quality management, on behalf of the firm, evaluate the system of quality management and concludes whether the system of quality management provides the firm with reasonable assurance that the objectives of the system, stated in paragraph 15*a–b*, are being achieved. (Ref: par. A5)

Scalability

- 11.** In applying a risk-based approach, the firm is required to take into account
 - a.* the nature and circumstances of the firm, and
 - b.* the nature and circumstances of the engagements performed by the firm.

Accordingly, the design of the firm's system of quality management, in particular, the complexity and formality of the system, will vary. For example, a firm that performs different

types of engagements for a wide variety of entities, such as audits of specialized industries or group audits for multinational entities, will likely need to have a more complex and formalized system of quality management and supporting documentation than a firm that performs only reviews of financial statements or compilation engagements.

Networks and Service Providers

- 12.** This proposed SQMS addresses the firm’s responsibilities when the firm
- a.* belongs to a network, and the firm complies with network requirements or uses network services in the system of quality management or in performing engagements, or
 - b.* uses resources from a service provider in the system of quality management or in performing engagements.

Even when the firm complies with network requirements or uses network services or resources from a service provider, the firm is responsible for its system of quality management.

Authority of This Proposed SQMS

- 13.** Paragraph 15 contains the objective of the firm in following this proposed SQMS. This proposed SQMS contains the following: (Ref: par. A6)
- a.* Requirements designed to enable the firm to meet the objective in paragraph 15 (Ref: par. A7)
 - b.* Related guidance in the form of application and other explanatory material (Ref: par. A8)
 - c.* Introductory material that provides context relevant to a proper understanding of this proposed SQMS
 - d.* Definitions (Ref: par. A9)

Effective Date

- 14.** Systems of quality management in compliance with this proposed SQMS are required to be designed and implemented by [December 15, 2023],* and the evaluation of the system of quality management required by paragraphs 54–55 is required to be performed within one year following [December 15, 2023].

Objective

- 15.** The objective of the firm is to design, implement, and operate a system of quality management for engagements performed by the firm in its accounting and auditing practice that provides the firm with reasonable assurance that
- a.* the firm and its personnel fulfill their responsibilities in accordance with professional

* This date is provisional but will not be earlier than December 15, 2023.

standards and applicable legal and regulatory requirements and conduct engagements in accordance with such standards and requirements, and

b. engagement reports issued by the firm are appropriate in the circumstances.

16. The public interest is served by the consistent performance of quality engagements. The design, implementation, and operation of the system of quality management enables the consistent performance of quality engagements by providing the firm with reasonable assurance that the objectives of the system of quality management, stated in paragraph 15*a–b*, are achieved. Quality engagements are achieved through planning and performing engagements and reporting on them in accordance with professional standards and applicable legal and regulatory requirements. Achieving the objectives of those standards and complying with the requirements of applicable law or regulation involves exercising professional judgment and, when applicable to the type of engagement, exercising professional skepticism.

Definitions

17. For purposes of the SQMSs, the following terms have the meanings attributed as follows:

Accounting and auditing practice. A practice that performs engagements covered by this section, which are audit, attestation, review, compilation, and any other services for which standards have been promulgated by the AICPA Auditing Standards Board (ASB) or the AICPA Accounting and Review Services Committee under the “General Standards Rule” (ET sec. 1.300.001)[†] or the “Compliance With Standards Rule” (ET sec. 1.310.001) of the AICPA Code of Professional Conduct. Although standards for other engagements may be promulgated by other AICPA technical committees, engagements performed in accordance with those standards are not encompassed in the definition of an *accounting and auditing practice*.

Deficiency in the firm’s system of quality management (referred to as *deficiency in this proposed SQMS*). This exists when (Ref: par. A10 and A169–A170)

- a quality objective required to achieve the objective of the system of quality management is not established;
- a quality risk, or combination of quality risks, is not identified or properly assessed; (Ref: par. A11)
- a response, or combination of responses, does not reduce to an acceptably low level the likelihood of a related quality risk occurring because the responses are not properly designed, implemented, or operating effectively; or
- an other aspect of the system of quality management is absent, or not properly designed, implemented, or operating effectively, such that a requirement of this proposed SQMS has not been addressed. (Ref: par. A12–A13)

[†] All ET sections can be found in AICPA *Professional Standards*.

Engagement documentation. The record of work performed, results obtained, and conclusions the practitioner reached (terms such as *working papers* or *work papers* are sometimes used).

Engagement partner. The partner or other individual, appointed by the firm, who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal, or regulatory body.

Engagement quality review. An objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon performed by the engagement quality reviewer and completed on or before the date of the engagement report.

Engagement quality reviewer. A partner, other individual in the firm, or an external individual, appointed by the firm to perform the engagement quality review.

Engagement team. All partners and staff performing the engagement, and any other individuals who perform procedures on the engagement, excluding an external specialist¹ and internal auditors who provide direct assistance on an engagement. (Ref: par. A14)

External inspections. Inspections or investigations, undertaken by an external oversight authority, related to the firm’s system of quality management or engagements performed by the firm. (Ref: par. A15)

Findings (in relation to a system of quality management). Information about the design, implementation, and operation of the system of quality management that has been accumulated from the performance of monitoring activities, external inspections, and other relevant sources, which indicates that one or more deficiencies may exist. (Ref: par. A16–A18)

Firm. A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the AICPA and that is engaged in public practice. (Ref: par. A19)

Network. An association of entities, as defined in “Definitions” in the AICPA Code of Professional Conduct (ET section 0.400). (Ref: par. A20)

Network firm. A firm or other entity that belongs to a network, as defined in “Definitions” in the AICPA Code of Professional Conduct (ET section 0.400). References to a *network firm* are to be read hereafter as “another firm or entity that belongs to the same network as the firm.”

Partner. Any individual with authority to bind the firm with respect to the performance of a professional services engagement. For purposes of this definition, *partner* may include

¹ Paragraph .06 of AU-C section 620, *Using the Work of an Auditor’s Specialist*, defines the term *auditor’s specialist*.

an employee with this authority who has not assumed the risks and benefits of ownership. Firms might use different titles to refer to individuals with this authority.

Personnel. Partners and staff in the firm. (Ref: par. A21–A22)

Professional judgment. The application of relevant training, knowledge, and experience, within the context of professional standards, in making informed decisions about the courses of action that are appropriate in the design, implementation, and operation of the firm’s system of quality management.

Professional standards. Standards promulgated by the ASB or the AICPA Accounting and Review Services Committee under the “General Standards Rule” (ET sec. 1.300.001) or the “Compliance With Standards Rule” (ET sec. 1.310.001) of the AICPA Code of Professional Conduct, or other standard-setting bodies that set auditing and attest standards applicable to the engagement being performed and relevant ethical requirements.

Quality objectives. The desired outcomes in relation to the components of the system of quality management to be achieved by the firm.

Quality risk. A risk that has a reasonable possibility of

- occurring, and
- individually, or in combination with other risks, adversely affecting the achievement of one or more quality objectives.

Reasonable assurance. In the context of the SQMSs, a high, but not absolute, level of assurance.

Relevant ethical requirements. Principles of professional ethics and ethical requirements to which the firm, engagement team, engagement quality reviewer, and other firm personnel are subject when undertaking engagements in the firm’s accounting and auditing practice, which consist of the AICPA Code of Professional Conduct together with rules of applicable state boards of accountancy and applicable regulatory agencies that are more restrictive. (Ref: par. A23–A24 and A64)

Response (in relation to a system of quality management). Policies or procedures designed and implemented by the firm to address one or more quality risks: (Ref: par. A25–A27 and A52)

- *Policies* are statements of what should, or should not, be done to address quality risks. Such statements may be documented, explicitly stated in communications, or implied through actions and decisions.
- *Procedures* are actions to implement policies.

Service provider (in the context of this proposed SQMS). An individual or organization external to the firm that provides a resource that is used in the system of quality management or in performing engagements. Service providers exclude the firm’s

network, other network firms, or other structures or organizations in the network. (Ref: par. A28 and A110)

Staff. Professionals, other than partners, including any experts the firm employs.

System of quality management. A system designed, implemented, and operated by a firm to provide the firm with reasonable assurance that

- a. the firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements; and
- b. engagement reports issued by the firm or engagement partners are appropriate in the circumstances.

Requirements

Applying and Complying With Relevant Requirements

18. The firm shall comply with each requirement of this proposed SQMS unless the requirement is not relevant to the firm because of the nature and circumstances of the firm or its engagements. (Ref: par. A29)
19. The individuals assigned ultimate responsibility and accountability for the firm's system of quality management, and the individuals assigned operational responsibility for the firm's system of quality management, should have an understanding of this proposed SQMS, including the application and other explanatory material, to understand the objective of this proposed SQMS and to apply its requirements properly.

System of Quality Management

20. The firm should design, implement, and operate a system of quality management. In doing so, the firm should exercise professional judgment, taking into account the nature and circumstances of the firm and its engagements. The governance and leadership component of the system of quality management establishes the environment that supports the design, implementation, and operation of the system of quality management (Ref: par. A30–A31)

Responsibilities

21. The firm should assign (Ref: par. A32–A36)
 - a. ultimate responsibility and accountability for the system of quality management to the firm's CEO or the firm's managing partner (or equivalent) or, if appropriate, the firm's managing board of partners (or equivalent);
 - b. operational responsibility for the system of quality management; and
 - c. operational responsibility for specific aspects of the system of quality management, including
 - i. compliance with independence requirements, and (Ref: par. A37)
 - ii. the monitoring and remediation process.

22. In assigning the roles in paragraph 21, the firm should determine that the individuals (Ref: par. A38)
 - a. have the appropriate experience, knowledge, influence, and authority within the firm and sufficient time to fulfill their assigned responsibility, and (Ref: par. A39)
 - b. understand their assigned roles and that they are accountable for fulfilling them.
23. The firm should determine that the individuals assigned operational responsibility for the system of quality management, compliance with independence requirements, and the monitoring and remediation process, have a direct line of communication to the individuals assigned ultimate responsibility and accountability for the system of quality management.

The Firm's Risk Assessment Process

24. The firm should design and implement a risk assessment process to establish quality objectives, identify and assess quality risks, and design and implement responses to address the quality risks. (Ref: par. A40–A42)
25. The firm should establish the quality objectives specified by this proposed SQMS and any additional quality objectives considered necessary by the firm to achieve the objectives of the system of quality management. (Ref: par. A43–A45)
26. The firm should identify and assess quality risks to provide a basis for the design and implementation of responses. In doing so, the firm should do the following:
 - a. Obtain an understanding of the conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of the quality objectives, including the following: (Ref: par. A46–A48)
 - i. With respect to the nature and circumstances of the firm, those relating to
 - (1) the complexity and operating characteristics of the firm;
 - (2) the strategic and operational decisions and actions, business processes, and business model of the firm;
 - (3) the characteristics and management style of leadership;
 - (4) the resources of the firm, including the resources provided by service providers;
 - (5) law, regulation, professional standards, and the environment in which the firm operates; and
 - (6) in the case of a firm that belongs to a network, the nature and extent of the network requirements and network services, if any
 - ii. With respect to the nature and circumstances of the engagements performed by the firm, those relating to
 - (1) the types of engagements performed by the firm and the reports to be issued, and

- (2) the types of entities for which such engagements are undertaken
- b.* Take into account how, and the degree to which, the conditions, events, circumstances, actions, or inactions in paragraph 26*a* may adversely affect the achievement of the quality objectives. (Ref: par. A49–A50)
- 27.** The firm should design and implement responses to address the quality risks in a manner that is based on, and responsive to, the reasons for the assessments given to the quality risks. The firm’s responses should also include the responses specified in paragraph 35. (Ref: par. A51–A53)
- 28.** The firm should establish policies or procedures that are designed to identify information that indicates additional quality objectives, or additional or modified quality risks or responses, are needed due to changes in the nature and circumstances of the firm or its engagements. If such information is identified, the firm should consider the information and, when appropriate (Ref: par. A54–A55)
 - a.* establish additional quality objectives or modify additional quality objectives previously established by the firm; (Ref: par. A56)
 - b.* identify and assess additional quality risks, modify the quality risks, or reassess the quality risks; or
 - c.* design and implement additional responses or modify the responses.

Governance and Leadership

- 29.** The firm should establish the following quality objectives that address the firm’s governance and leadership, which establishes the environment that supports the system of quality management:
 - a.* The firm demonstrates a commitment to quality through a culture that exists throughout the firm, which recognizes and reinforces the following: (Ref: par. A57–A58)
 - i.* The firm’s role in serving the public interest by consistently performing quality engagements
 - ii.* The importance of professional ethics, values, and attitudes
 - iii.* The responsibility of all personnel for quality relating to the performance of engagements or activities within the system of quality management and their expected behavior
 - iv.* The importance of quality in the firm’s strategic decisions and actions, including the firm’s financial and operational priorities
 - b.* Leadership is responsible and accountable for quality. (Ref: par. A59)
 - c.* Leadership demonstrates a commitment to quality through its actions and behaviors. (Ref: par. A60)
 - d.* The organizational structure and assignment of roles, responsibilities, and authority is appropriate to enable the design, implementation, and operation of the firm’s system of quality management. (Ref: par. A32–A35 and A61)

- e.* Resource needs, including financial resources, are planned for, and resources are obtained, allocated, or assigned in a manner that is consistent with the firm's commitment to quality. (Ref: par. A62–A63)

Relevant Ethical Requirements

- 30.** The firm should establish the following quality objectives that address the fulfillment of responsibilities in accordance with relevant ethical requirements, including those related to independence: (Ref: par. A64–A66 and A68)
 - a.* The firm and its personnel
 - i.* understand the relevant ethical requirements to which the firm and the firm's engagements are subject, and (Ref: par. A23)
 - ii.* fulfill their responsibilities in relation to the relevant ethical requirements to which the firm and the firm's engagements are subject.
 - b.* Others, including the network, network firms, individuals in the network or network firms, or service providers, who are subject to the relevant ethical requirements to which the firm and the firm's engagements are subject
 - i.* understand the relevant ethical requirements that apply to them, and (Ref: par. A23, A67)
 - ii.* fulfill their responsibilities in relation to the relevant ethical requirements that apply to them. (Ref: par. A68)

Acceptance and Continuance of Client Relationships and Specific Engagements

- 31.** The firm should establish the following quality objectives that address the acceptance and continuance of client relationships and specific engagements:
 - a.* Judgments by the firm about whether to accept or continue a client relationship or specific engagement are appropriate based on the following:
 - i.* Information obtained about the nature and circumstances of the engagement and the integrity and ethical values of the client (including management, and, when appropriate, those charged with governance) that is sufficient to support such judgments (Ref: par. A69–A74)
 - ii.* The firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements (Ref: par. A75–A76)
 - b.* The financial and operational priorities of the firm do not lead to inappropriate judgments about whether to accept or continue a client relationship or specific engagement. (Ref: par. A77–A78)

Engagement Performance

- 32.** The firm should establish the following quality objectives that address the performance of quality engagements:

- a. Engagement teams understand and fulfill their responsibilities in connection with the engagements, including, as applicable, the overall responsibility of engagement partners for managing and achieving quality on the engagement and being sufficiently and appropriately involved throughout the engagement. (Ref: par. A79)
- b. The nature, timing, and extent of direction and supervision of engagement teams and review of the work performed is appropriate based on the nature and circumstances of the engagements. The resources assigned or made available to the engagement teams; the work performed by less experienced engagement team members is directed, supervised, and reviewed by more experienced engagement team members. (Ref: par. A80–A81)
- c. Engagement teams exercise appropriate professional judgment and, when applicable to the type of engagement, professional skepticism. (Ref: par. A82)
- d. Consultation on difficult or contentious matters is undertaken, and the conclusions agreed to are implemented. (Ref: par. A83–A85)
- e. Differences of opinion within the engagement team, or between the engagement team and the engagement quality reviewer or individuals performing activities within the firm’s system of quality management, are brought to the attention of the firm and resolved. (Ref: par. A86)
- f. Engagement documentation is assembled on a timely basis after the date of the engagement report and is appropriately maintained and retained to meet the needs of the firm and comply with law, regulation, relevant ethical requirements, and professional standards. (Ref: par. A87–A89)

Resources

- 33. The firm should establish the following quality objectives that address appropriately obtaining, developing, using, maintaining, allocating, and assigning resources in a timely manner to enable the design, implementation, and operation of the system of quality management: (Ref: par. A90–A91)

Human Resources

- a. Personnel are hired, developed, and retained and have the competence and capabilities to (Ref: par. A92–A94)
 - i. consistently perform quality engagements, including having knowledge or experience relevant to the engagements the firm performs, or
 - ii. perform activities or carry out responsibilities in relation to the operation of the firm’s system of quality management.
- b. Personnel demonstrate a commitment to quality through their actions and behaviors, develop and maintain the appropriate competence to perform their roles, and are held accountable or recognized through timely evaluations, compensation, promotion, and other incentives. (Ref: par. A95–A97)
- c. Individuals are obtained from external sources (that is, the network, another network firm, or a service provider) when the firm does not have sufficient or appropriate

personnel to enable the operation of firm's system of quality management or performance of engagements. (Ref: par. A98)

- d. Engagement team members are assigned to each engagement, including an engagement partner, who have appropriate competence and capabilities, including being given sufficient time, to consistently perform quality engagements. (Ref: par. A92–A93, A99–A101)
- e. Individuals who have appropriate competence and capabilities, including sufficient time, to perform such activities are assigned to perform activities within the system of quality management.

Technological Resources

- f. Appropriate technological resources are obtained or developed, implemented, maintained, and used to enable the operation of the firm's system of quality management and the performance of engagements. (Ref: par. A102–A106 and A109)

Intellectual Resources

- g. Appropriate intellectual resources are obtained or developed, implemented, maintained, and used to enable the operation of the firm's system of quality management and the consistent performance of quality engagements, and such intellectual resources are consistent with professional standards and applicable legal and regulatory requirements, where applicable. (Ref: par. A107–A109)

Service Providers

- h. Human, technological, or intellectual resources from service providers are appropriate for use in the firm's system of quality management and in performing engagements, taking into account the quality objectives in paragraph 33d–g. (Ref: par. A110–A115)

Information and Communication

- 34. The firm should establish the following quality objectives that address obtaining, generating, or using information regarding the system of quality management and communicating information within the firm and to external parties on a timely basis to enable the design, implementation, and operation of the system of quality management: (Ref: par. A116)
 - a. The information system identifies, captures, processes, and maintains relevant and reliable information that supports the system of quality management, whether from internal or external sources. (Ref: par. A117–A119)
 - b. The culture of the firm recognizes and reinforces the responsibility of personnel to exchange information with the firm and with one another. (Ref: par. A120)
 - c. Relevant and reliable information is exchanged throughout the firm and with engagement teams, including the following: (Ref: par. A120)
 - i. Information is communicated to personnel and engagement teams, and the nature, timing, and extent of the information is sufficient to enable them to understand and carry out their responsibilities relating to performing activities within the system of quality management or engagements.

- ii. Personnel and engagement teams communicate information to the firm when performing activities within the system of quality management or engagements.
- d. Relevant and reliable information is communicated to external parties, including the following:
 - i. Information is communicated by the firm to or within the firm’s network or to service providers, if any, enabling the network or service providers to fulfill their responsibilities relating to the network requirements or network services or resources provided by them. (Ref: par. A121)
 - ii. Information is communicated externally when required by law, regulation, or professional standards or to support external parties’ understanding of the system of quality management. (Ref: par. A122–A123)

Specified Responses

- 35.** In designing and implementing responses in accordance with paragraph 27, the firm should include the following responses: (Ref: par. A124)
- a. The firm establishes policies or procedures for
 - i. identifying, evaluating, and addressing threats to compliance with the relevant ethical requirements. (Ref: par. A125)
 - ii. identifying, communicating, evaluating, and reporting of any breaches of the relevant ethical requirements and appropriately responding to the causes and consequences of the breaches in a timely manner. (Ref: par. A126–A127)
 - b. The firm obtains, at least annually, a documented confirmation of compliance with independence requirements from all personnel required by relevant ethical requirements to be independent.
 - c. The firm establishes policies or procedures for receiving, investigating, and resolving complaints and allegations about failures to perform work in accordance with professional standards and applicable legal and regulatory requirements or noncompliance with the firm’s policies or procedures established in accordance with this proposed SQMS. (Ref: par. A128–A129)
 - d. The firm establishes policies or procedures that address the following circumstances:
 - i. The firm becomes aware of information subsequent to accepting or continuing a client relationship or specific engagement that would have caused it to decline the client relationship or specific engagement had that information been known prior to accepting or continuing the client relationship or specific engagement. (Ref: par. A130–A131)
 - ii. The firm is obligated by law or regulation to accept a client relationship or specific engagement. (Ref: par. A132–A133)
 - e. The firm establishes policies or procedures that (Ref: par. A134–A137)
 - i. address when it is appropriate to communicate with external parties about the firm’s system of quality management, and (Ref: par. A138–A140)

- ii. address the information to be provided when communicating externally about the firm's system of quality management, including the nature, timing, and extent and appropriate form of communication. (Ref: par. A141–A142)
- f. The firm establishes policies or procedures that address engagement quality reviews in accordance with proposed SQMS *Engagement Quality Reviews* and requires an engagement quality review for the following:
 - i. Audits or other engagements for which an engagement quality review is required by law or regulation (Ref: par. A143)
 - ii. Audits or other engagements for which the firm determines that an engagement quality review is an appropriate response to address one or more quality risks (Ref: par. A144–A147)

Monitoring and Remediation Process

- 36.** The firm should establish a monitoring and remediation process to (Ref: par. A148)
- a. provide relevant, reliable, and timely information about the design, implementation, and operation of the system of quality management.
 - b. take appropriate actions to respond to identified deficiencies such that deficiencies are remediated on a timely basis.

Designing and Performing Monitoring Activities

- 37.** The firm should design and perform monitoring activities to provide a basis for the identification of deficiencies.
- 38.** In determining the nature, timing, and extent of the monitoring activities, the firm should take the following into account: (Ref: par. A149–A152)
- a. The reasons for the assessments given to the quality risks
 - b. The design of the responses
 - c. The design of the firm's risk assessment process and monitoring and remediation process (Ref: par. A153–A155)
 - d. Changes in the system of quality management (Ref: par. A156)
 - e. The results of previous monitoring activities, whether previous monitoring activities continue to be relevant in evaluating the firm's system of quality management and whether remedial actions to address previously identified deficiencies were effective (Ref: par. A157–A158)
 - f. Other relevant information, including complaints and allegations about failures to perform work in accordance with professional standards and applicable legal and regulatory requirements or noncompliance with the firm's policies or procedures established in accordance with this proposed SQMS, information from external inspections, and information from service providers (Ref: par. A159–A161)
- 39.** The firm should include the inspection of completed engagements in its monitoring activities and should determine which engagements and engagement partners to select. In doing so, the firm should (Ref: par. A150 and A162–A166)

- a. take into account the matters in paragraph 38;
 - b. consider the nature, timing, and extent of other monitoring activities undertaken by the firm and the engagements and engagement partners subject to such monitoring activities; (Ref: par. A167) and
 - c. select at least one completed engagement for each engagement partner on a cyclical basis determined by the firm.
- 40.** The firm should establish policies or procedures that
- a. require the individuals performing the monitoring activities to have the competence and capabilities, including sufficient time, to perform the monitoring activities effectively.
 - b. address the objectivity of the individuals performing the monitoring activities. Such policies or procedures should prohibit the engagement team members or the engagement quality reviewer of an engagement from performing any inspection of that engagement. (Ref: par. A168–A169)

Evaluating Findings and Identifying Deficiencies

- 41.** The firm should evaluate findings to determine whether deficiencies exist, including in the monitoring and remediation process. (Ref: par. A170–A174)

Evaluating Identified Deficiencies

- 42.** The firm should evaluate the severity and pervasiveness of identified deficiencies by (Ref: par. A173, A175–A176)
- a. investigating the root causes of the identified deficiencies. In determining the nature, timing, and extent of the procedures to investigate the root causes, the firm should take into account the nature of the identified deficiencies and their possible severity. (Ref: par. A177–A181)
 - b. evaluating the effect of the identified deficiencies, individually and in aggregate, on the system of quality management.

Responding to Identified Deficiencies

- 43.** The firm should design and implement remedial actions to address identified deficiencies that are responsive to the results of the root cause analysis. (Ref: par. A182–A184)
- 44.** The individuals assigned operational responsibility for the monitoring and remediation process should evaluate whether the remedial actions
- a. are appropriately designed to address the identified deficiencies and their related root causes and determine that they have been implemented.
 - b. implemented to address previously identified deficiencies are effective.
- 45.** If the evaluation indicates that the remedial actions are not appropriately designed and implemented or are not effective, the individuals assigned operational responsibility for the monitoring and remediation process should take appropriate action to determine that the remedial actions are appropriately modified such that they are effective.

Findings About a Particular Engagement

- 46.** The firm should respond to circumstances when findings indicate that there is an engagement for which required procedures were omitted during the performance of the engagement, or the report issued may be inappropriate. The firm's response should include the following: (Ref: par. A185)
- a.* Taking appropriate action to comply with relevant professional standards and applicable legal and regulatory requirements
 - b.* When the report is considered to be inappropriate, considering the implications and taking appropriate action, including considering whether to obtain legal advice

Ongoing Communication Related to Monitoring and Remediation

- 47.** The individuals assigned operational responsibility for the monitoring and remediation process should communicate the following on a timely basis to the individuals assigned ultimate responsibility and accountability for the system of quality management and the individuals assigned operational responsibility for the system of quality management: (Ref: par. A186)
- a.* A description of the monitoring activities performed
 - b.* The identified deficiencies, including the severity and pervasiveness of such deficiencies
 - c.* The remedial actions to address the identified deficiencies
- 48.** The firm should communicate the matters described in paragraph 47 to engagement teams and other individuals assigned activities within the system of quality management to enable them to take prompt and appropriate action in accordance with their responsibilities.

Network Requirements or Network Services

- 49.** When the firm belongs to a network, the firm should understand the following, when applicable: (Ref: par. A20 and A187–A189)
- a.* The requirements established by the network regarding the firm's system of quality management, including requirements for the firm to implement or use resources or services designed or otherwise provided by or through the network (that is, network requirements)
 - b.* Any services or resources provided by the network that the firm chooses to implement or use in the design, implementation, or operation of the firm's system of quality management (that is, network services)
 - c.* The firm's responsibilities for any actions that are necessary to implement the network requirements or use network services (Ref: par. A190)

The firm remains responsible for its system of quality management, including professional judgments made in the design, implementation, and operation of the system of quality management. The firm should not allow compliance with the network requirements or use of network services to contravene the requirements of this proposed SQMS. (Ref: par. A20 and A191)

- 50.** Based on the understanding obtained in accordance with paragraph 49, the firm should
- a.* determine how the network requirements or network services are relevant to, and are taken into account in, the firm’s system of quality management, including how they are to be implemented. (Ref: par. A192)
 - b.* evaluate whether and, if so, how the network requirements or network services need to be adapted or supplemented by the firm to be appropriate for use in its system of quality management. (Ref: par. A193–A195)

Monitoring Activities Undertaken by the Network on the Firm’s System of Quality Management

- 51.** In circumstances when the network performs monitoring activities relating to the firm’s system of quality management, the firm should
- c.* determine the effect of the monitoring activities performed by the network on the nature, timing, and extent of the firm’s monitoring activities performed in accordance with paragraphs 37–39;
 - d.* determine the firm’s responsibilities in relation to the monitoring activities, including any related actions by the firm; and
 - e.* as part of evaluating findings and identifying deficiencies in paragraph 41, obtain the results of the monitoring activities from the network in a timely manner. (Ref: par. A196)

Monitoring Activities Undertaken by the Network Across the Network Firms

- 52.** The firm should
- a.* understand the overall scope of the monitoring activities undertaken by the network across the network firms, including monitoring activities to determine that network requirements have been appropriately implemented across the network firms, and how the network will communicate the results of its monitoring activities to the firm.
 - b.* at least annually, obtain information from the network about the overall results of the network’s monitoring activities across the network firms, if applicable, and (Ref: par. A197–A199)
 - i.* communicate the information to engagement teams and other individuals assigned activities within the system of quality management, as appropriate, to enable them to take prompt and appropriate action in accordance with their responsibilities, and
 - ii.* consider the effect of the information on the firm’s system of quality management.

Deficiencies in Network Requirements or Network Services Identified by the Firm

- 53.** If the firm identifies a deficiency in the network requirements or network services, the firm should (Ref: par. A200)
- a.* communicate to the network relevant information about the identified deficiency, and
 - b.* in accordance with paragraph 43, design and implement remedial actions to address

the effect of the identified deficiency in the network requirements or network services. (Ref: par. A201)

Evaluating the System of Quality Management

- 54.** The individuals assigned ultimate responsibility and accountability for the system of quality management should evaluate, on behalf of the firm, the system of quality management. The evaluation should be undertaken as of a point in time and performed at least annually. (Ref: par. A202–A205)
- 55.** Based on the evaluation, the individuals assigned ultimate responsibility and accountability for the system of quality management should conclude, on behalf of the firm, one of the following: (Ref: par. A206 and A213)
 - a.* The system of quality management provides the firm with reasonable assurance that the objectives of the system of quality management are being achieved. (Ref: par. A207)
 - b.* Except for matters related to identified deficiencies that have a severe but not pervasive effect on the design, implementation, and operation of the system of quality management, the system of quality management provides the firm with reasonable assurance that the objectives of the system of quality management are being achieved. (Ref: par. A208)
 - c.* The system of quality management does not provide the firm with reasonable assurance that the objectives of the system of quality management are being achieved. (Ref: par. A208–A212)
- 56.** If the individuals assigned ultimate responsibility and accountability for the system of quality management reaches the conclusion described in paragraph 55*b* or 55*c*, the firm should do the following: (Ref: par. A214)
 - a.* Take prompt and appropriate action
 - b.* Communicate to
 - i.* engagement teams and other individuals assigned activities within the system of quality management to the extent that it is relevant to their responsibilities, and (Ref: par. A215)
 - ii.* external parties in accordance with the firm’s policies or procedures required by paragraph 35*e*. (Ref: par. A216)
- 57.** The firm should undertake periodic performance evaluations of the individuals assigned ultimate responsibility and accountability for the system of quality management and the individuals assigned operational responsibility for the system of quality management. In doing so, the firm should take into account the evaluation of the system of quality management. (Ref: par. A217–A219)

Documentation

- 58.** The firm should prepare documentation of its system of quality management that is sufficient to (Ref: par. A220–A222)

- a. support a consistent understanding of the system of quality management by personnel, including an understanding of their roles and responsibilities with respect to the system of quality management and performing engagements.
- b. support the consistent implementation and operation of the responses.
- c. provide evidence of the design, implementation, and operation of the responses to support the evaluation of the system of quality management by the individuals assigned ultimate responsibility and accountability for the system of quality management.

59. In preparing documentation, the firm should include the following:

- a. Identification of the individuals assigned ultimate responsibility and accountability for the system of quality management and operational responsibility for the system of quality management
- b. The firm’s quality objectives and quality risks (Ref: par. A223)
- c. A description of the responses and how the firm’s responses address the quality risks
- d. Regarding the monitoring and remediation process:
 - i. Evidence of the monitoring activities performed
 - ii. The evaluation of findings, and identified deficiencies and their related root causes
 - iii. Remedial actions to address identified deficiencies and the evaluation of the design and implementation of such remedial actions
 - iv. Communications about monitoring and remediation
- e. The basis for the conclusion reached pursuant to paragraph 55

60. The firm should document the matters in paragraph 59 as they relate to network requirements or network services and the evaluation of the network requirements or network services in accordance with paragraph 50*b*. (Ref: par. A224)

61. The firm should establish a period of time for the retention of documentation for the system of quality management that is sufficient to enable the firm to monitor the design, implementation, and operation of the firm’s system of quality management or for a longer period if required by law or regulation.

Application and Other Explanatory Material

Scope of This Proposed SQMS (Ref: par. 3–4)

A1. Other professional standards, including AT-C section 105, *Concepts Common to All Attestation Engagements*[‡], and AR-C section 60, *General Principles for Engagements Performed*

[‡] All AT-C sections can be found in AICPA *Professional Standards*.

*in Accordance With Statements on Standards for Accounting and Review Services,*¹ also establish requirements for the engagement partner for the management of quality at the engagement level.

A2. The AICPA code establishes the fundamental principles of professional ethics, which include the obligation to act in a way that serves the public interest.² As indicated in paragraph 16, in the context of engagement performance as described in this proposed SQMS, the consistent performance of quality engagements forms part of the obligation to act in the public interest.

The Firm's System of Quality Management (Ref: par. 7–10)

A3. The firm may use different terminology or frameworks to describe the components of its system of quality management.

A4. Examples of the interconnected nature of the components include the following:

- The firm's risk assessment process sets out the process the firm is required to follow in implementing a risk-based approach across the system of quality management.
- The governance and leadership component establishes the environment that supports the system of quality management.
- The resources and information and communication components enable the design, implementation, and operation of the system of quality management.
- The monitoring and remediation process is designed to monitor the entire system of quality management. The results of the monitoring and remediation process provide information that is relevant to the firm's risk assessment process.
- There may be relationships between specific matters, for example, certain aspects of relevant ethical requirements are relevant to accepting and continuing client relationships and specific engagements.

A5. Reasonable assurance is obtained when the system of quality management reduces to an acceptably low level the risk that the objectives stated in paragraph 15*a–b* are not achieved. Reasonable assurance is not an absolute level of assurance because there are inherent limitations of a system of quality management. Such limitations include that human judgment in decision making can be faulty and that breakdowns in a firm's system of quality management may occur, for example, due to human error or behavior or failures in IT applications.

Authority of This Proposed SQMS (Ref: par. 13)

A6. The objective of this proposed SQMS provides the context in which the requirements of this proposed SQMS are set, establishes the desired outcome of this proposed SQMS, and is intended to assist the firm in understanding what needs to be accomplished and, when necessary, the appropriate means of doing so.

A7. The requirements of this proposed SQMS are expressed using the word *should*.

A8. When necessary, the application and other explanatory material provides further explanation of the requirements and guidance for carrying them out. In particular, it may

¹ All AR-C sections can be found in AICPA *Professional Standards*.

² ET section 0.300.030.01.

- explain more precisely what a requirement means or is intended to cover, and
- include examples that illustrate how the requirements might be applied.

Although such guidance does not, in itself, impose a requirement, it is relevant to the proper application of the requirements. The application and other explanatory material may also provide background information on matters addressed in this proposed SQMS. These additional considerations assist in the application of the requirements in this proposed SQMS. They do not, however, limit or reduce the responsibility of the firm to apply and comply with the requirements in this proposed SQMS.

A9. This proposed SQMS includes, under the heading, “Definitions,” a description of the meanings attributed to certain terms for purposes of this proposed SQMS. These definitions are provided to assist in the consistent application and interpretation of this proposed SQMS and are not intended to override definitions that may be established for other purposes, whether in law, regulation, or otherwise.

Definitions

Deficiency (Ref: par. 17b)

A10. The firm identifies deficiencies by evaluating findings. A deficiency may arise from a finding or a combination of findings.

A11. When a deficiency is identified as a result of a quality risk, or combination of quality risks, not being identified or properly assessed, the responses to address such quality risks may also be absent or not appropriately designed or implemented.

A12. The other aspects of the system of quality management consist of the requirements in this proposed SQMS addressing the following:

- Assigning responsibilities (paragraphs 21–22)
- The firm’s risk assessment process
- The monitoring and remediation process
- The evaluation of the system of quality management

A13. Examples of deficiencies related to other aspects of the system of quality management include the following:

- The firm’s risk assessment process fails to identify information that indicates changes in the nature and circumstances of the firm and its engagements and the need to establish additional quality objectives or modify the quality risks or responses.
- The firm’s monitoring and remediation process is not designed or implemented in a manner that
 - provides relevant, reliable, and timely information about the design, implementation, and operation of the system of quality management.
 - enables the firm to take appropriate actions to respond to identified deficiencies such that deficiencies are remediated on a timely basis.

- The individuals assigned ultimate responsibility and accountability for the system of quality management do not undertake the annual evaluation of the system of quality management.

Engagement Team (Ref: par. 17g)

A14. Proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*³ provides guidance in applying the definition of *engagement team* in the context of an audit of financial statements. AU-C section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*,⁴ expands on how proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards* is to be applied in relation to an audit of group financial statements. The quality risks and responses to those risks relevant to group audit engagements may be different for engagement team members who are firm personnel than for engagement team members who are external to the firm (for example, engagement team members who are from network firms or are service providers, such as component auditors from firms not within the firm’s network).

External Inspections (Ref: par. 17h)

A15. In some circumstances, an external oversight authority may undertake other types of inspections, for example, reviews that focus on, for a selection of firms, particular aspects of audit engagements or firm-wide practices.

Findings (Ref: par. 17i)

A16. As part of accumulating findings from monitoring activities, external inspections, and other relevant sources, the firm may identify other observations about the firm’s system of quality management, such as positive outcomes or opportunities for the firm to improve, or further enhance, the system of quality management. Paragraph A168 explains how other observations may be used by the firm in the system of quality management.

A17. Paragraph A157 provides examples of information from other relevant sources.

A18. Monitoring activities include monitoring at the engagement level, such as inspection of engagements. Furthermore, external inspections and other relevant sources may include information that relates to specific engagements. As a result, information about the design, implementation, and operation of the system of quality management includes engagement-level findings that may be indicative of findings in relation to the system of quality management.

Firm (Ref: par. 17j)

A19. The definition of *firm* in relevant ethical requirements may differ from the definition set out in this proposed SQMS.

Network (Ref: par. 17k and 49)

³ Paragraphs A15–A21 of proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

⁴ All AU-C sections can be found in AICPA *Professional Standards*.

A20. Networks and the firms within the network may be structured in a variety of ways. For example, in the context of a firm’s system of quality management:

- The network may establish requirements for the firm related to its system of quality management or provide services that are used by the firm in its system of quality management or in performing engagements.
- Other firms within the network may provide services (for example, resources) that are used by the firm in its system of quality management or in performing engagements.
- Other structures or organizations within the network may establish requirements for the firm related to its system of quality management or provide services.

For the purposes of this proposed SQMS, any network requirements or network services that are obtained from the network, another firm within the network, or another structure or organization in the network are considered “network requirements or network services.”

Personnel (Ref: par. 17n)

A21. In addition to personnel (that is, individuals in the firm), the firm may use individuals external to the firm in performing activities in the system of quality management or in performing engagements. For example, individuals external to the firm may include individuals from other network firms (for example, individuals in a service delivery center of a network firm) or individuals employed by a service provider (for example, a component auditor from another firm not within the firm’s network).

A22. Personnel also includes partners and staff in other structures of the firm, such as a service delivery center in the firm.

Relevant Ethical Requirements (Ref: par. 17t and 30)

A23. The relevant ethical requirements that are applicable in the context of a system of quality management may vary, depending on the nature and circumstances of the firm and its engagements. The AICPA code acknowledges that federal, state, or local statutes, rules, or regulations may be more restrictive than the AICPA code.

A24. Various provisions of the relevant ethical requirements may apply only to individuals in the context of the performance of engagements and not the firm itself. For example, the AICPA code prohibits individuals from knowingly misrepresenting facts or subordinating their judgment when performing professional services for a client or for an employer (ET sec. 1.100.001). Compliance with such relevant ethical requirements by individuals may need to be addressed by the firm’s system of quality management.

Response (Ref: par. 17u)

A25. Policies are implemented through the actions of personnel and other individuals whose actions are subject to the policies (including engagement teams) or through their restraint from taking actions that would conflict with the firm’s policies.

A26. Procedures may be mandated, through formal documentation or other communications, or may result from behaviors that are not mandated but, rather, are conditioned by the firm’s culture. Procedures may be enforced through the actions permitted by IT applications or other aspects of the firm’s IT environment.

A27. If the firm uses individuals external to the firm in the system of quality management or in performing engagements, different policies or procedures may need to be designed by the firm to address the actions of the individuals. Proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*⁵ provides guidance when different policies or procedures may need to be designed by the firm to address the actions of individuals external to the firm in the context of an audit of financial statements.

Service Provider (Ref: par. 17v)

A28. Service providers include component auditors from other firms not within the firm’s network.

Applying, and Complying With, Relevant Requirements (Ref: par. 18)

A29. Examples of when a requirement of this proposed SQMS may not be relevant to the firm include the following:

- The firm is a sole practitioner. For example, the requirements addressing the organizational structure and assigning roles, responsibilities, and authority within the firm; direction, supervision, and review; and addressing differences of opinion may not be relevant.
- The firm only performs engagements that are preparation of financial statements engagements. For example, because the firm is not required to maintain independence for preparation of financial statements engagements, the requirement to obtain a documented confirmation of compliance with independence requirements from all personnel would not be relevant.

System of Quality Management

Design, Implement, and Operate a System of Quality Management (Ref: par. 20)

A30. Quality management is not a separate function of the firm; it is the integration of a culture that demonstrates a commitment to quality with the firm’s strategy, operational activities, and business processes. As a result, designing the system of quality management and the firm’s operational activities and business processes in an integrated manner may promote a harmonious approach to managing the firm and enhance the effectiveness of quality management.

A31. The quality of professional judgments exercised by the firm is likely to be enhanced when individuals making such judgments demonstrate an attitude that includes an inquiring mind, which involves

- considering the source, relevance, and sufficiency of information obtained about the system of quality management, including information related to the nature and circumstances of the firm and its engagements, and
- being open and alert to a need for further investigation or other action.

⁵ Paragraphs A22–A24 of proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

Responsibilities (Ref: par. 21–22 and 29d)

A32. The governance and leadership component includes a quality objective that the firm has an organizational structure and assignment of roles, responsibilities, and authority that is appropriate to enable the design, implementation, and operation of the firm’s system of quality management.

A33. Notwithstanding the assignment of responsibilities related to the system of quality management in accordance with paragraph 21, the firm remains ultimately responsible for the system of quality management and holding individuals responsible and accountable for their assigned roles. For example, in accordance with paragraphs 54 and 55, although the firm assigns the evaluation of the system of quality management and conclusion thereon to the individuals assigned ultimate responsibility and accountability for the system of quality management, the firm is responsible for the evaluation and conclusion.

A34. An individual assigned responsibility for the matters in paragraph 21 is typically a partner of the firm so that the individual has appropriate influence and authority within the firm, as required by paragraph 22. However, based on the legal structure of the firm, there may be circumstances when an individual may not be a partner of the firm, but the individual has the appropriate influence and authority within the firm to perform the assigned role because of formal arrangements made by the firm or the firm’s network.

A35. How the firm assigns roles, responsibilities, and authority within the firm may vary, and law or regulation may impose certain requirements for the firm that affect the leadership and management structure or their assigned responsibilities. An individual assigned responsibility for a matter in paragraph 21 may further assign roles, procedures, tasks, or actions to other individuals to assist the individual in fulfilling the responsibilities. However, an individual assigned responsibility for a matter in paragraph 22 remains responsible and accountable for the responsibilities assigned to the individual.

A36. An example of scalability to demonstrate how assigning roles and responsibilities may be undertaken in firms of different complexity is as follows:

- In a less complex firm, ultimate responsibility and accountability for the system of quality management may be assigned to a single managing partner with sole responsibility for the oversight of the firm. This individual may also assume responsibility for all aspects of the system of quality management, including operational responsibility for the system of quality management, compliance with independence requirements, and the monitoring and remediation process.
- In a more complex firm, the organizational structure of the firm may include the multiple levels of leadership, and the firm may have an independent governing body that has nonexecutive oversight of the firm, which may comprise external individuals. Furthermore, the firm may assign operational responsibility for specific aspects of the system of quality management beyond those specified in paragraph 21c, such as operational responsibility for compliance with ethical requirements or operational responsibility for managing a service line.

A37. Compliance with independence requirements is essential to the performance of engagements in a firm’s accounting and auditing practice and is an expectation of stakeholders relying on the firm’s reports. The individuals assigned operational responsibility for compliance

with independence requirements are ordinarily responsible for the oversight of all matters related to independence so that a robust and consistent approach is designed and implemented by the firm to deal with independence requirements.

A38. Law, regulation, or professional standards may establish additional requirements for an individual assigned responsibility for a matter in paragraph 21, such as requirements for professional licensing, professional education, or continuing professional development.

A39. The appropriate experience and knowledge for the individuals assigned operational responsibility for the system of quality management ordinarily includes an understanding of the firm's strategic decisions and actions and experience with the firm's business operations.

The Firm's Risk Assessment Process (Ref: par. 24)

A40. How the firm designs the firm's risk assessment process may be affected by the nature and circumstances of the firm, including how the firm is structured and organized.

Examples of scalability to demonstrate how the firm's risk assessment process may differ from that of other firms include the following:

- In a less complex firm, the individuals assigned operational responsibility for the system of quality management may have a sufficient understanding of the firm and its engagements to undertake the risk assessment process. Furthermore, the documentation of the quality objectives, quality risks, and responses may be less extensive than for a more complex firm (for example, it may be documented in a single document).
- In a more complex firm, there may be a formal risk assessment process involving multiple individuals and numerous activities. The process may be centralized (for example, the quality objectives, quality risks, and responses are established centrally for all business units, functions, and service lines) or decentralized (for example, the quality objectives, quality risks, and responses are established at a business unit, function, or service line level, with the outputs combined at the firm level). The firm's network may also provide the firm with quality objectives, quality risks, and responses to be included in the firm's system of quality management.

A41. The process of establishing quality objectives, identifying and assessing quality risks, and designing and implementing responses is iterative, and the requirements of this proposed SQMS are not intended to be addressed in a linear manner. Examples of the iterative and nonlinear nature of the firm's risk assessment process include the following:

- In identifying and assessing quality risks, the firm might determine that an additional quality objective needs to be established.
- When designing and implementing responses, the firm might determine that a quality risk was not identified and assessed.

A42. Information sources that enable the firm to establish quality objectives, identify and assess quality risks, and design and implement responses are part of the firm's information and communication component and include the following:

- The results of the firm's monitoring and remediation process (see paragraphs 43 and A169).

- Information from the network or service providers, including
 - information about network requirements or network services (see paragraph 49), and
 - other information from the network, including information about the results of monitoring activities undertaken by the network across the network firms (see paragraphs 51–52).

Other information, either internal or external, may also be relevant to the firm’s risk assessment process, such as the following:

- Information regarding complaints and allegations about failures to perform work in accordance with professional standards and applicable legal and regulatory requirements or noncompliance with the firm’s policies or procedures established in accordance with this proposed SQMS
- The results of external inspections
- Information from regulators about the entities for whom the firm performs engagements, which is made available to the firm, such as information from a securities regulator about an entity for whom the firm performs engagements (for example, irregularities in the entity’s financial statements or noncompliance with securities regulations)
- Changes in the system of quality management that affect other aspects of the system, for example, changes in the firm’s resources
- Other external sources, such as regulatory actions and litigation against the firm or other firms in the jurisdiction that may highlight areas for the firm to consider

Establish Quality Objectives (Ref: par. 25)

A43. Law, regulation, or professional standards may establish requirements that give rise to additional quality objectives. For example, if a firm is required by law or regulation to appoint nonexecutive individuals to the firm’s governance structure, the firm may consider it necessary to establish additional quality objectives to address the requirements.

A44. The nature and circumstances of the firm and its engagements may be such that the firm may not find it necessary to establish additional quality objectives.

A45. The firm may establish sub-objectives to enhance the firm’s identification and assessment of quality risks, and design and implementation of responses.

Identify and Assess Quality Risks (Ref: par. 26)

A46. There may be other conditions, events, circumstances, actions, or inactions not described in paragraph 26a that may adversely affect the achievement of a quality objective.

A47. A risk arises from how, and the degree to which, a condition, event, circumstance, action, or inaction may adversely affect the achievement of a quality objective. Not all risks meet the definition of a *quality risk*. Professional judgment assists the firm in determining whether a risk is a quality risk, which is based on the firm’s consideration of whether there is a reasonable

possibility of the risk occurring, and individually, or in combination with other risks, adversely affecting the achievement of one or more quality objectives.

A48. Examples of the firm’s understanding of the conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of the quality objectives and the related quality risks are as follows:

<p>Examples of the firm’s understanding of the conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of the quality objectives</p>	<p>Examples of quality risks that may arise</p>
<p>The strategic and operational decisions and actions, business processes, and business model of the firm: The firm’s overall financial goals are overly dependent on the extent of services provided by the firm not within the scope of this proposed SQMS.</p>	<p>In the context of governance and leadership, this may give rise to a number of quality risks such as the following:</p> <ul style="list-style-type: none"> • Resources are allocated or assigned in a manner that prioritizes the services not within the scope of this proposed SQMS and may negatively affect the quality of engagements within the scope of this proposed SQMS. • Decisions about financial and operational priorities do not fully or adequately consider the importance of quality in performing engagements within the scope of this proposed SQMS.
<p>The characteristics and management style of leadership: The firm is a smaller firm with a few engagement partners with shared authority.</p>	<p>In the context of governance and leadership, this may give rise to a number of quality risks such as the following:</p> <ul style="list-style-type: none"> • Leadership’s responsibilities and accountability for quality are not clearly defined and assigned. • The actions and behaviors of leadership that do not promote quality are not questioned.

<p>The complexity and operating characteristics of the firm: The firm has recently completed a merger with another firm.</p>	<p>In the context of resources, this may give rise to a number of quality risks, including the following:</p> <ul style="list-style-type: none"> • Technological resources used by the two merged firms may be incompatible. • Engagement teams may use intellectual resources developed by a firm prior to the merger, which are no longer consistent with the new methodology being used by the new merged firm.
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A49. Given the evolving nature of the system of quality management, the responses designed and implemented by the firm may give rise to conditions, events, circumstances, actions, or inactions that result in further quality risks. For example, the firm may implement a resource (for example, a technological resource) to address a quality risk, and quality risks may arise from the use of such resource.

A50. The degree to which a risk, individually or in combination with other risks, may adversely affect the achievement of a quality objective may vary based on the conditions, events, circumstances, actions, or inactions giving rise to the risk, taking matters such as the following into account:

- How the condition, event, circumstance, action, or inaction would affect the achievement of the quality objective
- How frequently the condition, event, circumstance, action, or inaction is expected to occur
- How long it would take after the condition, event, circumstance, action, or inaction occurred for it to have an effect, and whether in that time the firm would have an opportunity to respond to mitigate the effect of the condition, event, circumstance, action, or inaction.
- How long the condition, event, circumstance, action, or inaction would affect the achievement of the quality objective once it has occurred.

The assessment of quality risks need not comprise formal ratings or scores, although firms are not precluded from using them.

Design and Implement Responses to Address the Quality Risks (Ref: par. 17u and 27)

A51. The nature, timing, and extent of the responses are based on the reasons for the assessment given to the quality risks, that is, the conclusions from the consideration of how, and the degree to

which, conditions, events, circumstances, actions, or inaction may adversely affect the achievement of one or more quality objectives.

A52. The responses designed and implemented by the firm may operate at the firm level or engagement level, or there may be a combination of responsibilities for actions to be taken at the firm and engagement level. An example of a response designed and implemented by the firm that operates at both the firm and engagement level is as follows:

The firm establishes policies or procedures for consultation, which include with whom consultation should be undertaken by engagement teams and the specific matters for which consultation is required. The firm appoints suitably qualified and experienced individuals to provide the consultations. The engagement team is responsible for identifying when matters for consultation occur and initiating consultation, and implementing the conclusions from consultation.

A53. The need for formally documented policies or procedures may be greater for firms that have many personnel or that are geographically dispersed, in order to achieve consistency across the firm.

Changes in the Nature and Circumstances of the Firm or Its Engagements (Ref: par. 28)

A54. Examples of scalability to demonstrate how policies or procedures for identifying information about changes in the nature and circumstances of the firm and its engagements may vary from other firms include the following:

- In a less complex firm, the firm may have informal policies or procedures to identify information about changes in the nature and circumstances of the firm or its engagements, particularly when the individuals responsible for establishing quality objectives, identifying and assessing quality risks, and designing and implementing responses are able to identify such information in the normal course of their activities.
- In a more complex firm, the firm may need to establish more formal policies or procedures to identify and consider information about changes in the nature and circumstances of the firm or its engagements. This may include, for example, a periodic review of information relating to the nature and circumstances of the firm and its engagements, including ongoing tracking of trends and occurrences in the firm's internal and external environment.

A55. Additional quality objectives may need to be established, or quality risks and responses added to or modified, as part of the remedial actions undertaken by the firm to address an identified deficiency in accordance with paragraph 43.

A56. The firm may have established quality objectives in addition to those specified by this proposed SQMS. The firm may also identify information that indicates that additional quality objectives previously established by the firm are no longer needed or need to be modified.

Governance and Leadership

Commitment to Quality (Ref: par. 29a)

A57. The firm’s culture is an important factor in influencing the behavior of personnel. Relevant ethical requirements ordinarily establish the principles of professional ethics and are further addressed in the “Relevant Ethical Requirements” section of this proposed SQMS. Professional values and attitudes may include the following:

- Professional manner, for example, timeliness, courteousness, respect, accountability, responsiveness, and dependability
- A commitment to teamwork
- Maintaining an open mind to new ideas or different perspectives in the professional environment
- Pursuit of excellence
- A commitment to continual improvement (for example, setting expectations beyond the minimum requirements and placing a focus on continual learning)
- Social responsibility

A58. The firm’s strategic decision-making process, including the establishment of a business strategy, may include matters such as the firm’s decisions about financial and operational matters, the firm’s financial goals, how financial resources are managed, growth of the firm’s market share, industry specialization, or new service offerings. The firm’s financial and operational priorities may directly or indirectly affect the firm’s commitment to quality, for example, the firm may have incentives that are focused on financial and operational priorities that may discourage behaviors that demonstrate a commitment to quality.

Leadership (Ref: par. 29b and 29c)

A59. The responses designed and implemented by the firm to hold leadership responsible and accountable for quality include the performance evaluations required by paragraph 57.

A60. Although leadership establishes the tone at the top through its actions and behaviors, clear, consistent, and frequent actions and communications at all levels within the firm collectively contribute to the firm’s culture and demonstrates a commitment to quality.

Organizational Structure (Ref: par. 29d)

A61. The organizational structure of the firm may include operating units, operational processes, divisions, or geographical locations and other structures. In some instances, the firm may concentrate or centralize processes or activities in a service delivery center, and engagement teams may include personnel from the firm’s service delivery center who perform specific tasks that are repetitive or specialized in nature.

Resources (Ref: par. 29e)

A62. The individuals assigned ultimate responsibility and accountability or operational responsibility for the system of quality management are, in most cases, able to influence the nature and extent of resources that the firm obtains, develops, uses, and maintains and how those resources are allocated or assigned, including the timing of when they are used.

A63. Because resource needs may change over time, it may not be practicable to anticipate all resource needs. The firm's resource planning may involve determining the resources currently required, forecasting the firm's future resource needs, and establishing processes to deal with unanticipated resource needs when they arise.

Relevant Ethical Requirements (Ref: par. 17*t* and 30)

A64. The AICPA code sets out the fundamental principles of ethics that provide the framework for the rules that govern the performance of professional responsibilities. The fundamental principles are responsibilities, the public interest, integrity, objectivity and independence, due care, and scope and nature of services. Independence requirements are set forth in the "Independence Rule" (ET sec. 1.200) and related interpretations of the AICPA code and the rules of state boards of accountancy and applicable regulatory agencies. Guidance on threats to independence and safeguards to mitigate such threats involving matters that are not explicitly addressed in the AICPA code are set forth in the "Conceptual Framework for Independence" (ET sec. 1.210.010).

A65. In some cases, the matters addressed by the firm in its system of quality management may be more specific than, or additional to, the provisions of relevant ethical requirements. Examples of matters that a firm may include in its system of quality management that are more specific than, or additional to, the provisions of relevant ethical requirements include the following:

- The firm prohibits the acceptance of gifts and hospitality from a client, even if the value is trivial and inconsequential.
- The firm sets rotation periods for all engagement partners, including those performing attestation, review, and compilation engagements.

A66. Other components may affect or relate to the relevant ethical requirements component. Examples of relationships between the relevant ethical requirements component and other components include the following:

- The information and communication component may address the communication of various matters related to relevant ethical requirements, including
 - the firm communicating the independence requirements to all personnel and others subject to independence requirements.
 - personnel and engagement teams communicating relevant information to the firm without fear of reprisals, such as situations that may create threats to independence or breaches of relevant ethical requirements.
- As part of the resources component, the firm may
 - assign individuals to manage and monitor compliance with relevant ethical requirements or to provide consultation on matters related to relevant ethical requirements.

- use IT applications to monitor compliance with relevant ethical requirements, including recording and maintaining information about independence.

A67. The relevant ethical requirements that apply to others depend on the provisions of the relevant ethical requirements and how the firm uses others in its system of quality management or in performing engagements. Examples of relevant ethical requirements that apply to others include the following:

- Relevant ethical requirements may include requirements for independence that apply to network firms or employees of network firms, for example, the AICPA code includes independence requirements that apply to network firms.
- Relevant ethical requirements may include a definition of *engagement team* or other similar concept, and the definition may include any individual who performs assurance procedures on the engagement (for example, a service provider engaged to attend a physical inventory count at a remote location). Accordingly, any requirements of the relevant ethical requirements that apply to the engagement team as defined in the relevant ethical requirements, or other similar concept, may also be relevant to such individuals.
- The principle of confidentiality may apply to the firm’s network, other network firms, or service providers when they have access to client information obtained by the firm.

A68. AU-C section 600⁶ states that when component auditors are not subject to the AICPA code, compliance with the ethics and independence requirements set forth in the International Federation of Accountants Code of Ethics for Professional Accountants is sufficient to fulfill the component auditor’s ethical responsibilities in the group audit.⁷ Procedures the firm may use regarding the fulfillment of relevant ethical requirements that apply to them by network firms, employees of network firms, or service providers may include confirmations, letters of representation, or other affirmations.

Acceptance and Continuance of Client Relationships and Specific Engagements

The Nature and Circumstances of the Engagement and the Integrity and Ethical Values of the Client (Ref: par. 31a(i))

A69. The information obtained about the nature and circumstances of the engagement may include the following:

- The industry of the entity for which the engagement is being undertaken and relevant regulatory factors

⁶ Paragraph .A46 of AU-C section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*.

⁷ The section, “Application of the AICPA Code” (ET sec. 0.200.020), of the AICPA Code of Professional Conduct (AICPA code) explains that an AICPA member who is the group engagement partner of a U.S. consolidated entity should be considered to have performed an audit in accordance with generally accepted auditing standards, and in compliance with the AICPA code, provided that component auditors that are not subject to the AICPA code are in compliance with the ethics and independence requirements set forth in the International Federation of Accountants Code of Ethics.

- The nature of the entity, for example, its operations, organizational structure, ownership and governance, its business model, and how it is financed
- The nature of the underlying subject matter and the applicable criteria, for example, in the case of sustainability reporting:
 - The underlying subject matter may include social, environmental, or health and safety information.
 - The applicable criteria may be performance measures established by a recognized body of experts.

A70. The information obtained to support the firm’s judgments about the integrity and ethical values of the client may include the identity and business reputation of the client’s principal owners, key management, and those charged with its governance.

A71. Examples of factors that may affect the nature and extent of information obtained about the integrity and ethical values of the client include the following:

- The nature of the entity for which the engagement is being performed, including the complexity of its ownership and management structure
- The nature of the client’s operations, including its business practices
- Information concerning the attitude of the client’s principal owners, key management, and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment
- Whether the client is aggressively concerned with keeping the firm’s fees as low as possible
- Indications of a client-imposed limitation in the scope of work
- Indications that the client might be involved in money laundering or other criminal activities
- The reasons for the proposed appointment of the firm and non-reappointment of the previous firm
- The identity and business reputation of related parties

A72. The firm may obtain the information from a variety of internal and external sources, including the following:

- In the case of an existing client, information from current or previous engagements, if applicable, or inquiry of other personnel who have performed other engagements for the client.
- In the case of a new client, inquiry of existing or previous providers of auditing services to the client, in accordance with relevant ethical requirements.
- Discussions with other third parties, such as bankers, legal counsel, and industry peers.
- Background searches of relevant databases (which may be intellectual resources). In some cases, the firm may use a service provider to perform the background search.

A73. Information that is obtained during the firm’s acceptance and continuance process also may often be relevant to the engagement team when planning and performing the engagement. Professional standards may specifically require the engagement team to obtain or consider such information. For example, proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*⁸ requires the engagement partner to take into account information obtained in the acceptance and continuance process in planning and performing the audit engagement.

A74. Professional standards or applicable legal and regulatory requirements may include specific provisions that need to be addressed before accepting or continuing a client relationship or specific engagement and may also require the firm to make inquiries of an existing or predecessor firm when accepting an engagement. For example, when there has been a change of auditors, AU-C section 210, *Terms of Engagement*,⁹ requires the auditor, prior to starting an initial audit, to request management to authorize the predecessor auditor to respond fully to the auditor’s inquiries regarding matters that will assist the auditor in determining whether to accept the engagement. The AICPA code also addresses consideration of conflicts of interests in accepting or continuing a client relationship or specific engagement (ET sec. 1.110.010).

The Firm’s Ability to Perform Engagements (Ref: par. 31a(ii))

A75. The firm’s ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements may be affected by the following:

- The availability of appropriate resources to perform the engagement
- Having access to information to perform the engagement or to the persons who provide such information
- Whether the firm and the engagement team are able to fulfill their responsibilities in relation to the relevant ethical requirements

A76. Examples of factors the firm may consider in determining whether appropriate resources are available to perform the engagement include the following:

- The circumstances of the engagement and the reporting deadline.
- The availability of individuals with the appropriate competence and capabilities, including sufficient time, to perform the engagement. This includes having
 - individuals to take overall responsibility for directing and supervising the engagement,
 - individuals with knowledge of the relevant industry or the underlying subject matter or criteria to be applied in the preparation of the subject matter information and experience with relevant regulatory or reporting requirements, and
 - individuals to perform audit procedures on the financial information of a component for purposes of an audit of group financial statements.

⁸ Paragraph 23 of proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

⁹ Paragraph .11 of AU-C section 210, *Terms of Engagement*.

- The availability of experts, if needed.
- If an engagement quality review is needed, whether there is an individual available who meets the eligibility requirements in proposed SQMS *Engagement Quality Reviews*.
- The need for technological resources, for example, IT applications that enable the engagement team to perform procedures on the entity's data.
- The need for intellectual resources, for example, a methodology, industry or subject-matter-specific guides, or access to information sources.

The Firm's Financial and Operational Priorities (Ref: par. 31b)

A77. Financial priorities may focus on the profitability of the firm, and fees obtained for performing engagements have an effect on the firm's financial resources. Operational priorities may include strategic focus areas, such as growth of the firm's market share, industry specialization, or new service offerings. There may be circumstances when the firm is satisfied with the fee quoted for an engagement, but it is not appropriate for the firm to accept or continue the engagement or client relationship (for example, when the client lacks integrity and ethical values).

A78. There may be other circumstances when the fee quoted for an engagement is not sufficient given the nature and circumstances of the engagement, and it may diminish the firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements. The AICPA code addresses fees and other types of remuneration.

Engagement Performance

Responsibilities of the Engagement Team and Direction, Supervision, and Review (Ref: par. 32a and 32b)

A79. Professional standards or applicable legal and regulatory requirements may include specific provisions regarding the overall responsibility of the engagement partner. For example, proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards* deals with the overall responsibility of the engagement partner for managing and achieving quality on the engagement and for being sufficiently and appropriately involved throughout the engagement, including responsibility for appropriate direction and supervision of the engagement team and review of their work.

A80. Examples of direction, supervision, and review include the following:

- Direction and supervision of the engagement team may include
 - tracking the progress of the engagement,
 - considering the following with respect to members of the engagement team:
 - Whether they understand their instructions
 - Whether the work is being carried out in accordance with the planned approach to the engagement
 - addressing matters arising during the engagement, considering their significance, and modifying the planned approach appropriately, and

- identifying matters for consultation or consideration by more experienced engagement team members during the engagement.
- A review of work performed may include considering whether
 - the work has been performed in accordance with the firm’s policies or procedures, professional standards, and applicable legal and regulatory requirements;
 - significant matters have been raised for further consideration;
 - appropriate consultations have been undertaken, and the resulting conclusions have been documented and implemented;
 - there is a need to revise the nature, timing, and extent of planned work;
 - the work performed supports the conclusions reached and is appropriately documented;
 - the evidence obtained for an assurance engagement is sufficient and appropriate to support the report; and
 - the objectives of the engagement procedures have been achieved.

A81. In some circumstances, the firm may use personnel from a service delivery center in the firm or individuals from a service delivery center in another network firm to perform procedures on the engagement, (that is, the personnel or other individuals are included in the engagement team). In such circumstances, the firm’s policies or procedures may specifically address the direction and supervision of the individuals and review of their work, such as

- what aspects of the engagement may be assigned to individuals in the service delivery center;
- how the engagement partner, or their designee, is expected to direct, supervise, and review the work undertaken by individuals in the service delivery center; and
- the protocols for communication between the engagement team and individuals in the service delivery center.

Professional Judgment and Professional Skepticism (Ref: par. 32c)

A82. Professional skepticism supports the quality of judgments made on an assurance engagement and, through these judgments, the overall effectiveness of the engagement team in performing the assurance engagement. Other professional standards may address the exercise of professional judgment or professional skepticism at the engagement level. For example, proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*¹⁰ provides examples of impediments to the exercise of professional skepticism at the engagement level, unconscious auditor biases that may impede the exercise of professional skepticism, and possible actions that the engagement team may take to mitigate such impediments.

¹⁰ Paragraphs A27–A29 of proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

Consultation (Ref: par. 32d)

A83. Consultation typically involves a discussion at the appropriate professional level, with individuals within or outside the firm who have specialized expertise, on difficult or contentious matters. An environment that reinforces the importance and benefit of consultation and encourages engagement teams to consult may contribute to supporting a culture that demonstrates a commitment to quality.

A84. Difficult or contentious matters on which consultation is needed may either be specified by the firm, or the engagement team may identify matters that require consultation. The firm may also specify how conclusions should be agreed upon and implemented.

A85. Proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*¹¹ includes requirements for the engagement partner related to consultation.

Differences of Opinion (Ref: par. 32e)

A86. The firm may encourage identifying differences of opinion at an early stage and may specify the steps to be taken in raising and dealing with them, including how the matter is to be resolved and how the related conclusions should be implemented and documented. In some circumstances, resolving differences of opinion may be achieved through consulting with another practitioner or firm, or a professional or regulatory body.

Engagement Documentation (Ref: par. 32f)

A87. Law, regulation, or professional standards may prescribe the time limits by which the assembly of final engagement files for specific types of engagements are to be completed. When no such time limits are prescribed, the time limit may be determined by the firm. For example, the case of engagements conducted in accordance with Statements on Standards for Attestation Engagements (SSAEs) or Statements on Standards for Accounting and Review Services (SSARSs), an appropriate time limit within which to complete the assembly of the final engagement file is ordinarily not more than 60 days after the date of the engagement report.

A88. The retention and maintenance of engagement documentation may include managing the safe custody, integrity, accessibility, or retrievability of the underlying data and the related technology. The retention and maintenance of engagement documentation may involve the use of IT applications. The integrity of engagement documentation may be compromised if it is altered, supplemented, or deleted without authorization to do so, or if it is permanently lost or damaged.

A89. Law, regulation, or professional standards may prescribe the retention periods for engagement documentation. If the retention periods are not prescribed, the firm may consider the nature of the engagements performed by the firm and the firm's circumstances, including whether the engagement documentation is needed to provide a record of matters of continuing significance to future engagements. In the case of engagements conducted under generally accepted auditing standards or the SSAEs, the retention period is ordinarily no shorter than five years from the date

¹¹ Paragraph 35 of proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

of the engagement report, or, if later, the date of the auditor's report on the group financial statements, when applicable.

Resources (Ref: par. 33)

A90. Resources for the purposes of the resources component include the following:

- Human resources
- Technological resources, for example, IT applications
- Intellectual resources, for example, written policies or procedures, a methodology, or guides

Financial resources are also relevant to the system of quality management because they are necessary for obtaining, developing, and maintaining the firm's human resources, technological resources, and intellectual resources. Given that the management and allocation of financial resources is strongly influenced by leadership, the quality objectives in governance and leadership, such as those that address financial and operational priorities, address financial resources.

A91. Resources may be internal to the firm or may be obtained externally from the firm's network, another network firm, or service provider. Resources may be used in performing activities within the firm's system of quality management or in performing engagements as part of operating the system of quality management. In circumstances when a resource is obtained from the firm's network or another network firm, paragraphs 49–53 form part of the responses designed and implemented by the firm in achieving the objectives in this component.

Human Resources

Hiring, Developing, and Retaining Personnel and Personnel Competence and Capabilities (Ref: par. 33a and d)

A92. *Competence* is the ability of the individual to perform a role and goes beyond knowledge of principles, standards, concepts, facts, and procedures; it is the integration and application of technical competence, professional skills, and professional ethics, values, and attitudes. Competence can be developed through a variety of methods, including professional education, continuing professional development, training, work experience, or coaching of less experienced engagement team members by more experienced engagement team members.

A93. Law, regulation, or professional standards may establish requirements addressing competence and capabilities. For example, law or regulation may establish requirements for the professional licensing of engagement partners, including requirements regarding their professional education and continuing professional development.

A94. The policies or procedures designed and implemented by the firm relating to hiring, developing, and retaining personnel may address, for example, the following:

- Recruiting individuals who have, or are able to develop, appropriate competence
- Training programs focused on developing the competence of personnel and continuing professional development
- Evaluation mechanisms that are undertaken at appropriate intervals and include competency areas and other performance measures

- Compensation, promotion, and other incentives, for all personnel, including engagement partners and individuals assigned roles and responsibilities related to the firm's system of quality management.

Personnel's Commitment to Quality and Accountability and Recognition for Commitment to Quality (Ref: par. 33b)

A95. Timely evaluations and feedback help support and promote the continual development of the competence of personnel. Less formal methods of evaluation and feedback may be used, such as in the case of firms with fewer personnel.

A96. Positive actions or behaviors demonstrated by personnel may be recognized through various means, such as through compensation, promotion, or other incentives. In some circumstances, simple or informal incentives that are not based on monetary rewards may be appropriate.

A97. The manner in which the firm holds personnel accountable for actions or behaviors that negatively affect quality, such as failing to demonstrate a commitment to quality, develop and maintain the competence to perform their role, or implement the firm's responses as designed, may depend on the nature of the action or behavior, including its severity and frequency of occurrence. The following are some actions the firm may take when personnel demonstrate actions or behaviors that negatively affect quality:

- Training or other professional development
- Considering the effect of the matter on the evaluation, compensation, promotion, or other incentives of those involved
- Disciplinary action, if appropriate

Individuals Obtained From External Sources (Ref: par. 33c)

A98. Professional standards may include responsibilities for the engagement partner regarding the appropriateness of resources. For example, proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*¹² addresses the responsibility of the engagement partner for determining that sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team in a timely manner in accordance with the firm's policies or procedures.

Engagement Team Members Assigned to Each Engagement (Ref: par. 33d)

A99. Engagement team members may be assigned to engagements by

- the firm, including assigning personnel from a service delivery center in the firm.
- the firm's network or another network firm when the firm uses individuals from the firm's network or another network firm to perform procedures on the engagement (for example, a component auditor or a service delivery center of the network or another network firm).

¹² Paragraph 25 of proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

- a service provider when the firm uses individuals from a service provider to perform procedures on the engagement (for example, a component auditor from a firm not within the firm’s network).

A100. Proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*¹³ addresses the responsibility of the engagement partner to determine that members of the engagement team, and any auditor’s external experts and internal auditors who provide direct assistance (who are not part of the engagement team), collectively have the appropriate competence and capabilities, including sufficient time, to perform the engagement. The responses designed and implemented by the firm to address the competence and capabilities of engagement team members assigned to the engagement may include policies or procedures that address the following:

- Information that may be obtained by the engagement partner and factors to consider in determining that the engagement team members assigned to the engagement, including those assigned by the firm’s network, another network firm, or service provider, have the competence and capabilities to perform the engagement
- How concerns about the competence and capabilities of engagement team members, in particular, those assigned by the firm’s network, another network firm, or service provider, may be resolved

A101. The requirements in paragraphs 49–53 are also applicable when using individuals from the firm’s network or another network firm on an engagement, including component auditors (see, for example, paragraph A190).

Technological Resources (Ref: par. 33f)

A102. Technological resources, which are typically IT applications, form part of the firm’s IT environment. The firm’s IT environment also includes the supporting IT infrastructure and the IT processes and human resources involved in those processes:

- An IT application is a program or a set of programs that is designed to perform a specific function directly for the user or, in some cases, for another application program.
- The IT infrastructure comprises the IT network, operating systems, and databases and their related hardware and software.
- The IT processes are the firm’s processes to manage access to the IT environment, program changes or changes to the IT environment, and IT operations, which includes monitoring the IT environment.

A103. A technological resource may serve multiple purposes within the firm, and some of the purposes may be unrelated to the system of quality management. Technological resources that are relevant for the purposes of this proposed SQMS are as follows:

- Technological resources that are directly used in designing, implementing, or operating the firm’s system of quality management

¹³ Paragraph 26 of proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

- Technological resources that are used directly by engagement teams in performing engagements
- Technological resources that are essential to enabling the effective operation of the preceding, such as, in relation to an IT application, the IT infrastructure and IT processes supporting the IT application

A104. Examples of scalability to demonstrate how the technological resources that are relevant for the purposes of this proposed SQMS may differ in firms of different complexity include the following:

- In a less complex firm, the technological resources may comprise a commercial IT application used by engagement teams, which has been purchased from a service provider. The IT processes that support the operation of the IT application may also be relevant, although they may be simple (for example, processes for authorizing access to the IT application and processing updates to the IT application).
- In a more complex firm, the technological resources may be more complex and may comprise the following:
 - Multiple IT applications, including custom-developed applications or applications developed by the firm’s network, such as
 - IT applications used by engagement teams (for example, engagement software and automated audit tools)
 - IT applications developed and used by the firm to manage aspects of the system of quality management (for example, IT applications to monitor independence or assign personnel to engagements)
 - The IT processes that support the operation of these IT applications, including the individuals responsible for managing the IT infrastructure and processes and the firm’s processes for managing program changes to IT applications

A105. The firm may consider the following matters in obtaining, developing, implementing, and maintaining an IT application:

- The data inputs are complete and appropriate.
- Confidentiality of the data is preserved.
- The IT application operates as designed and achieves the purpose for which it is intended.
- The outputs of the IT application achieve the purpose for which they will be used.
- The general IT controls necessary to support the IT application’s continued operation as designed are appropriate.
- The need for specialized skills to use the IT application effectively, including the training of individuals who will use the IT application.
- The need to develop procedures that set out how the IT application operates.

A106. The firm may specifically prohibit the use of IT applications or features of IT applications until such time that it has been determined that they operate appropriately and have been approved

for use by the firm. Alternatively, the firm may establish policies or procedures to address circumstances when the engagement team uses an IT application that is not approved by the firm. Such policies or procedures may require the engagement team to determine that the IT application is appropriate for use prior to using it on the engagement, through considering the matters in paragraph A102. Proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*¹⁴ addresses the engagement partner's responsibilities for engagement resources.

Intellectual Resources (Ref: par. 33g)

A107. Intellectual resources include the information the firm uses to enable the operation of the system of quality management and promote consistency in performing engagements. Examples of intellectual resources include written policies or procedures, a methodology, industry or subject-matter-specific guides, accounting guides, standardized documentation, or access to information sources (for example, subscriptions to websites that provide in-depth information about entities or other information that is typically used in performing engagements).

A108. Intellectual resources may be made available through technological resources, for example, the firm's methodology may be embedded in the IT application that facilitates the planning and performance of the engagement.

Use of Technological and Intellectual Resources (Ref: par. 33f–g)

A109. The firm may establish policies or procedures regarding the use of the firm's technological and intellectual resources. Examples of such policies or procedures include the following:

- Requiring the use of certain IT applications or intellectual resources in performing engagements, or relating to other aspects of the engagement, such as in archiving the engagement file
- Specifying the qualifications or experience that individuals need to use the resource, including the need for an expert or training, for example, the firm may specify the qualifications or expertise needed to use an IT application that analyzes data, given that specialized skills may be needed to interpret the results
- Specifying the responsibilities of the engagement partner regarding the use of technological and intellectual resources
- Setting out how the technological or intellectual resources are to be used, including how individuals should interact with an IT application or how the intellectual resource should be applied, and the availability of support or assistance in using the technological or intellectual resource

Service Providers (Ref: par. 17v and 33h)

A110. In some circumstances, the firm may use resources that are provided by a service provider, particularly in circumstances when the firm does not have access to the appropriate resources

¹⁴ Paragraphs 25–28 of proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

internally. Notwithstanding that a firm may use resources from a service provider, the firm remains responsible for its system of quality management.

A111. Examples of resources from a service provider include the following:

- Individuals engaged to perform the firm's monitoring activities or engagement quality reviews, or to provide consultation on technical matters
- A commercial IT application used to perform audit engagements
- Individuals performing procedures on the firm's engagements, for example, component auditors from firms not within the firm's network or individuals engaged to attend a physical inventory count at a remote location
- An auditor's external specialist used by the firm to assist the engagement team in obtaining audit evidence

A112. In identifying and assessing quality risks, the firm is required to obtain an understanding of the conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of the quality objectives, which includes conditions, events, circumstances, actions, or inactions relating to service providers. In doing so, the firm may consider the nature of the resources provided by service providers, how and the extent to which they will be used by the firm, and the general characteristics of the service providers used by the firm (for example, the varying types of other professional services firms that are used) to identify and assess quality risks related to the use of such resources.

A113. In determining whether a resource from a service provider is appropriate for use in the firm's system of quality management or performing engagements, the firm may obtain information about the service provider and the resource it provides from a number of sources. The following are matters the firm may consider:

- The related quality objective and quality risks. For example, in the case of a methodology from a service provider, there may be quality risks related to the quality objective in paragraph 33g, such as a quality risk that the service provider does not update the methodology to reflect changes in professional standards and applicable legal and regulatory requirements.
- The nature and scope of the resources and the conditions of the service (for example, in relation to an IT application, how often updates will be provided, limitations on the use of the IT application, and how the service provider addresses confidentiality of data).
- The extent to which the resource is used across the firm, how the resource will be used by the firm, and whether it is suitable for that purpose.
- The extent of customization of the resource for the firm.
- The firm's previous use of the service provider.
- The service provider's experience in the industry and reputation in the market.
- The results of assurance engagements performed by independent third parties on the resource (for example, assurance engagements on quality control materials or reports on service organization controls).

A114. The firm may have a responsibility to take further actions in using the resource from a service provider so that the resource functions effectively. For example, the firm may need to communicate information to the service provider in order for the resource to function effectively, or, in relation to an IT application, the firm may need to have supporting IT infrastructure and IT processes in place.

A115. The evaluation of a service provider from a firm not within the firm's network that is used as a component auditor may be different than that of a service provider engaged directly by the firm. For example, in understanding the competency of the component auditor to perform the engagement, it may not be necessary or practicable for the firm to obtain an understanding of how the component auditor updates its methodology to reflect changes in professional standards. Rather, the firm could perform procedures such as review of results of regulatory inspections, transparency or audit quality information published by the component auditor's firm, or evaluation of the reputation of the component auditor.

Information and Communication (Ref: par. 34)

A116. Obtaining, generating, or communicating information is generally an ongoing process that involves all personnel and encompasses the dissemination of information within the firm and externally. Information and communication are pervasive to all components of the system of quality management.

The Firm's Information System (Ref: par. 34a)

A117. Reliable and relevant information includes information that is accurate, complete, timely, and valid to enable the proper functioning of the firm's system of quality management and to support decisions regarding the system of quality management.

A118. The information system may include the use of manual or IT elements, which affect the manner in which information is identified, captured, processed, maintained, and communicated. The procedures to identify, capture, process, maintain, and communicate information may be enforced through IT applications, and in some cases, may be embedded within the firm's responses for other components. In addition, digital records may replace or supplement physical records.

A119. An example of scalability is that less complex firms with fewer personnel and direct involvement of leadership may not need rigorous policies and procedures that specify how information should be identified, captured, processed, and maintained.

Communication Within the Firm (Ref: par. 34b–c)

A120. The firm may recognize and reinforce the responsibility of personnel and engagement teams to exchange information with the firm and one another by establishing communication channels to facilitate communication across the firm. Examples of communication among the firm, engagement teams, and other individuals include the following:

- The firm communicates the responsibility for implementing the firm's responses to personnel and engagement teams.
- The firm communicates changes to the system of quality management to personnel and engagement teams to the extent that the changes are relevant to their responsibilities

and enables personnel and engagement teams to take prompt and appropriate action in accordance with their responsibilities.

- The firm communicates information that is obtained during the firm’s acceptance and continuance process that is relevant to engagement teams in planning and performing engagements.
- Engagement teams communicate the following information to the firm:
 - Information about the client that is obtained during the performance of an engagement that may have caused the firm to decline the client relationship or specific engagement had that information been known prior to accepting or continuing the client relationship or specific engagement.
 - Information about the operation of the firm’s responses (for example, concerns about the firm’s processes for assigning personnel to engagements), which, in some cases, may indicate a deficiency in the firm’s system of quality management.
- Engagement teams communicate information to the engagement quality reviewer or individuals providing consultation.
- Group engagement teams communicate matters to component auditors in accordance with the firm’s policies or procedures, including matters related to quality management at the engagement level.
- The individuals assigned operational responsibility for compliance with independence requirements communicate to relevant personnel and engagement teams changes in the independence requirements and the firm’s policies or procedures to address such changes.

Communication With External Parties

Communication to or Within the Firm’s Network and to Service Providers (Ref: par. 34d(i))

A121. In addition to the firm communicating information to or within the firm’s network or to a service provider, the firm may need to obtain information from the network, a network firm, or a service provider that supports the firm in the design, implementation, and operation of its system of quality management. For example, the firm may obtain information from the network or other network firms about clients of other network firms when there are independence requirements that affect the firm.

Communication With Others External to the Firm (Ref: par. 34d(ii))

A122. Examples of when law, regulation, or professional standards may require the firm to communicate information to external parties include the following:

- The firm becomes aware of noncompliance with laws and regulations by a client, and relevant ethical requirements require the firm to report the noncompliance with laws and regulations to an appropriate authority outside the client entity or to consider whether such reporting is an appropriate action in the circumstances.
- Law or regulation requires the firm to publish a transparency report and specifies the nature of the information that is required to be included in the transparency report.

- Securities law or regulation requires the firm to communicate certain matters to those charged with governance.

Paragraphs A131–A135 address communications to support external parties’ understanding of the system of quality management beyond those required by law, regulation, or professional standards.

A123. In some cases, law or regulation may preclude the firm from communicating information related to its system of quality management externally. Examples of when the firm may be precluded from communicating information externally include the following:

- Confidentiality law or regulation prohibits disclosure of certain information.
- Law, regulation, or relevant ethical requirements include provisions addressing the duty of confidentiality.

Specified Responses (Ref: par. 35)

A124. The specified responses may address multiple quality risks related to more than one quality objective across different components. For example, policies or procedures for complaints and allegations may address quality risks related to quality objectives in resources (for example, personnel’s commitment to quality), relevant ethical requirements, and governance and leadership. The specified responses alone are not sufficient to achieve the objectives of the system of quality management.

Relevant Ethical Requirements (Ref: par. 35a–b)

A125. Relevant ethical requirements may contain provisions regarding the identification and evaluation of threats and how they should be addressed. For example, the AICPA code provides a conceptual framework for this purpose and, in applying the conceptual framework, requires that the firm use the reasonable and informed third-party test.

A126. Relevant ethical requirements may specify how the firm is required to respond to a breach. For example, the “Breach of an Independence” interpretation (ET sec. 1.298.010) of the “Independence Rule” (ET sec. 1.200.001) contains guidance addressing a breach of an independence interpretation of the AICPA code, which also contains guidance addressing a breach of any other provision of the AICPA code.

A127. Matters the firm may address relating to breaches of the relevant ethical requirements include the following:

- The communication of breaches of the relevant ethical requirements to appropriate personnel
- The evaluation of the significance of a breach and its effect on compliance with relevant ethical requirements
- The actions to be taken to satisfactorily address the consequences of a breach, including that such actions be taken as soon as practicable
- Determining whether to report a breach to external parties, such as those charged with governance of the entity to which the breach relates or an external oversight authority

- Determining the appropriate actions to be taken in relation to the individuals responsible for the breach

Complaints and Allegations (Ref: par. 35c)

A128. Establishing policies or procedures for dealing with complaints and allegations may assist the firm in preventing engagement reports from being issued that are inappropriate. It also may assist the firm in

- identifying and dealing with individuals, including leadership, who do not act or behave in a manner that demonstrates a commitment to quality and supports the firm’s commitment to quality, or
- identifying deficiencies in the system of quality management.

A129. Complaints and allegations may be made by personnel or others external to the firm (for example, clients, component auditors, or individuals within the firm’s network).

Information That Becomes Known Subsequent to Accepting or Continuing a Client Relationship or Specific Engagement (Ref: par. 35d)

A130. Information that becomes known subsequent to accepting or continuing a client relationship or specific engagement may

- have existed at the time of the firm’s decision to accept or continue the client relationship or specific engagement, and the firm was not aware of such information, or
- relate to new information that has arisen since the decision to accept or continue the client relationship or specific engagement.

A131. Examples of matters addressed in the firm’s policies or procedures for circumstances in which information becomes known subsequent to accepting or continuing a client relationship or specific engagement that may have affected the firm’s decision to accept or continue a client relationship or specific engagement include the following:

- Undertaking consultation within the firm or with legal counsel
- Considering whether there is a professional, legal, or regulatory requirement for the firm to continue the engagement
- Discussing with the appropriate level of the client’s management and with those charged with governance or the engaging party the action that the firm might take based on the relevant facts and circumstances
- When it is determined that withdrawal is an appropriate action:
 - Informing the client’s management and those charged with governance or the engaging party of this decision and the reasons for the withdrawal
 - Considering whether there is a professional, legal, or regulatory requirement for the firm to report the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities

A132. In some circumstances, law or regulation may impose an obligation on the firm to accept or continue a client engagement.

A133. Examples of matters addressed in the firm's policies or procedures in circumstances in which the firm is obligated to accept or continue an engagement or the firm is unable to withdraw from an engagement, and the firm is aware of information that would have caused the firm to decline or discontinue the engagement, include the following:

- The firm considers the effect of the information on the performance of the engagement.
- The firm communicates the information to the engagement partner and requests the engagement partner to increase the extent and frequency of the direction and supervision of the engagement team members and review of their work.
- The firm assigns more experienced personnel to the engagement.
- The firm determines that an engagement quality review should be performed.

Communication With External Parties (Ref: par: 35e)

A134. The firm's ability to maintain stakeholder confidence in the quality of its engagements may be enhanced through relevant, reliable, and transparent communication by the firm about the activities that it has undertaken to address quality and the effectiveness of those activities.

A135. External parties who may use information about the firm's system of quality management, and the extent of their interest in the firm's system of quality management, may vary based on the nature and circumstances of the firm and its engagements.

A136. Examples of external parties who may use information about the firm's system of quality management include the following:

- Management or those charged with governance of the firm's clients may use the information to determine whether to appoint the firm to perform an engagement.
- External oversight authorities may have indicated a desire for the information to support their responsibilities in monitoring the quality of engagements across a jurisdiction and in understanding the work of firms.
- Other firms who use the work of the firm in performing engagements (for example, in relation to a group audit) may have requested such information.
- Other users of the firm's engagement reports, such as investors who use engagement reports in their decision making, may have indicated a desire for the information.

A137. The information about the system of quality management provided to external parties, including information communicated to those charged with governance about how the system of quality management supports the consistent performance of quality engagements, may address such matters as the following:

- The nature and circumstances of the firm, such as the organizational structure, business model, strategy, and operating environment
- The firm's governance and leadership, such as its culture, how it demonstrates a commitment to quality, and assigned roles, responsibilities, and authority with respect to the system of quality management

- How the firm fulfills its responsibilities in accordance with relevant ethical requirements, including those related to independence
- Factors that contribute to quality engagements, for example, such information may be presented in the form of engagement quality indicators with narrative to explain the indicators
- The results of the firm’s monitoring activities and external inspections and how the firm has remediated identified deficiencies or is otherwise responding to them
- The evaluation undertaken in accordance with paragraphs 54–55 of whether the system of quality management provides the firm with reasonable assurance that the objectives of the system are being achieved and the conclusion thereon, including the basis for the judgments made in evaluating and concluding
- How the firm has responded to emerging developments and changes in the circumstances of the firm or its engagements, including how the system of quality management has been adapted to respond to such changes
- The relationship between the firm and the network, the overall structure of the network, a description of network requirements and network services, the responsibilities of the firm and the network (including that the firm is ultimately responsible for the system of quality management), and information about the overall scope and results of network monitoring activities across the network firms

Determining When It Is Appropriate to Communicate With External Parties (Ref: par. 35e(i))

A138. The firm’s determination of when it is appropriate to communicate with external parties about the firm’s system of quality management is a matter of professional judgment and may be influenced by matters such as the following:

- The types of engagements performed by the firm
- The types of entities for which such engagements are undertaken, for example, entities that may have public interest or public accountability characteristics, such as
 - entities that hold a significant amount of assets in a fiduciary capacity for a large number of stakeholders, including financial institutions, such as certain banks, insurance companies, and pension funds
 - entities with a high public profile or whose management or owners have a high public profile
 - entities with a large number and wide range of stakeholders.
- The nature and circumstances of the firm
- The nature of the firm’s operating environment, such as customary business practice in the firm’s jurisdiction and the characteristics of the financial markets in which the firm operates
- The extent to which the firm has already communicated with external parties in accordance with law or regulation (that is, whether further communication is needed, and if so, the matters to be communicated)

- The expectations of stakeholders in the firm’s jurisdiction, including the understanding and interest that external parties have expressed about the engagements undertaken by the firm, and the firm’s processes in performing the engagements
- Jurisdictional trends
- The information that is already available to external parties
- How external parties may use the information, and their general understanding of matters related to firms’ system of quality management and engagements performed by the firm in its accounting and auditing practice
- The public interest benefits of external communication and whether it would reasonably be expected to outweigh the costs (monetary or otherwise) of such communication

The preceding matters may also affect the information provided by the firm in the communication and the nature, timing, and extent and appropriate form of communication.

A139. AU-C section 260, *The Auditor’s Communication With Those Charged With Governance*, deals with the auditor’s responsibility to communicate with those charged with governance in an audit of financial statements and addresses the auditor’s determination of the appropriate person or persons within the entity’s governance structure with whom to communicate¹⁵ and the communication process.¹⁶ In some circumstances, it may be appropriate to include information about the firm’s system of quality management in those communications with those charged with governance (or when performing other engagements, for example, review or examination engagements). How the communication with those charged with governance is undertaken (that is, by the firm or the engagement team) may depend on the firm’s policies or procedures and the circumstances of the engagement.

Considerations for Engagements for Governmental Organizations

A140. The firm may determine it is appropriate to communicate to those charged with governance of a governmental organization about how the firm’s system of quality management supports the consistent performance of quality engagements, taking into account the size and complexity of the governmental organization, the range of its stakeholders, the nature of the services it provides, and the roles and responsibilities of those charged with governance.

Nature, Timing, and Extent and Appropriate Form of Communication With External Parties (Ref: par: 35e(ii))

A141. The firm may consider the following attributes in preparing information that is communicated to external parties:

- The information is specific to the circumstances of the firm. Relating the matters in the firm’s communication directly to the specific circumstances of the firm may help to

¹⁵ Paragraphs .07–.09 of AU-C section 260, *The Auditor’s Communication With Those Charged With Governance*.

¹⁶ Paragraphs .15–.20 of AU-C section 260.

minimize the potential that such information becomes overly standardized and less useful over time.

- The information is presented in a clear and understandable manner, and the manner of presentation is neither misleading nor would inappropriately influence the users of the communication (for example, the information is presented in a manner that is appropriately balanced towards positive and negative aspects of the matter being communicated).
- The information is accurate and complete in all material respects and does not contain information that is misleading.
- The information takes into consideration the information needs of the users for whom it is intended. In considering the information needs of the users, the firm may consider matters such as the level of detail that users would find meaningful and whether users have access to relevant information through other sources (for example, the firm's website).

A142. The firm uses professional judgment in determining, in the circumstances, the appropriate form of communication with the external party, including communication with those charged with governance when performing an audit of financial statements of listed entities, which may be made orally or in writing. Accordingly, the form of communication may vary.

Examples of forms of communication to external parties include the following:

- A publication such as a transparency report or audit quality report
- Targeted written communication to specific stakeholders (for example, information about the results of the firm's monitoring and remediation process)
- Direct conversations and interactions with the external party (for example, discussions between the engagement team and those charged with governance)
- A web page
- Other forms of digital media, such as social media, or interviews or presentations via webcast or video

Engagements Subject to an Engagement Quality Review

Engagement Quality Review Required by Law or Regulation (Ref: par. 35f(i))

A143. Law or regulation may require an engagement quality review to be performed, for example, for audit engagements for entities that

- are *public interest entities* as defined in a particular jurisdiction,
- are governmental organizations or recipients of government funding, or entities with public accountability,
- operate in certain industries (for example, financial institutions such as banks, insurance companies, and pension funds),
- meet a specified asset threshold, or
- are under the management of a court or judicial process (for example, liquidation).

Engagement Quality Review as a Response to Address One or More Quality Risks (Ref: par. 35f(ii))

A144. The firm’s understanding of the conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of the quality objectives as required by paragraph 26a(ii), relates to the nature and circumstances of the engagements performed by the firm. In designing and implementing responses to address one or more quality risks, the firm may determine that an engagement quality review is an appropriate response based on the reasons for the assessments given to the quality risks.

A145. Criteria established by the firm to determine whether an engagement quality control review is an appropriate response for one or more quality risks may relate to the types of engagements performed by the firm and reports to be issued, and the types of entities for which engagements are undertaken. Examples of conditions, events, circumstances, actions, or inactions giving rise to such quality risks include the following:

Those relating to the types of engagements performed by the firm and reports to be issued:

- Engagements that involve a high level of complexity or judgment, such as the following:
 - Audits of financial statements for entities operating in an industry that typically has accounting estimates with a high degree of estimation uncertainty (for example, certain large financial institutions or mining entities) or for entities for which uncertainties exist related to events or conditions that may cast significant doubt on their ability to continue as a going concern
 - Assurance engagements that require specialized skills and knowledge in measuring or evaluating the underlying subject matter against the applicable criteria (for example, a greenhouse gas statement in which there are significant uncertainties associated with the quantities reported therein)
- Engagements on which issues have been encountered, such as audit engagements with recurring internal or external inspection findings, unremediated significant deficiencies in internal control, or a material restatement of comparative information in the financial statements
- Engagements for which unusual circumstances have been identified during the firm’s acceptance and continuance process (for example, a new client that had a disagreement with its previous auditor or assurance practitioner).
- Engagements that involve reporting on financial or nonfinancial information that is expected to be included in a regulatory filing, and that may involve a higher degree of judgment, such as pro forma financial information to be included in a prospectus

Those relating to the types of entities for which engagements are undertaken:

- Entities in emerging industries or for which the firm has no previous experience.
- Entities for which concerns were expressed in communications from regulators.
- Entities that may have public interest or public accountability characteristics, for example:

- Entities that hold a significant amount of assets in a fiduciary capacity for a large number of stakeholders, including financial institutions, such as certain banks, insurance companies, and pension funds for which an engagement quality review is not otherwise required by law or regulation
- Entities with a high public profile or whose management or owners have a high public profile
- Entities with a large number and wide range of stakeholders
- Governmental organizations
 - Due to their size and complexity, the range of their stakeholders or the nature of the services they provide
 - Due to the complexity, and importance to users, of additional reporting requirements established by law or regulation (for example, a separate report on instances of noncompliance with law or regulation to the legislature or other governing body or communicating such instances in the auditor’s report on the financial statements).

A146. The firm’s responses to address quality risks may include other forms of engagement reviews that are not an engagement quality review. For example, for audits of financial statements, the firm’s responses may include reviews of the engagement team’s procedures relating to significant risks, or reviews of certain significant judgments, by personnel who have specialized technical expertise. In some cases, these other types of engagement reviews may be undertaken in addition to an engagement quality review.

A147. In some cases, the firm may determine that there are no audits or other engagements for which an engagement quality review or another form of engagement review is an appropriate response to address the quality risks.

Monitoring and Remediation Process (Ref: par. 36–48)

A148. In addition to enabling the evaluation of the system of quality management, the monitoring and remediation process facilitates the proactive and continual improvement of engagement quality and the system of quality management. Examples follow:

- Given the inherent limitations of a system of quality management, the firm’s identification of deficiencies is not unusual, and it is an important aspect of the system of quality management because prompt identification of deficiencies enables the firm to remediate them in a timely and effective manner and contributes to a culture of continual improvement.
- The monitoring activities may provide information that enables the firm to prevent a deficiency through responding to a finding that could, over a period of time, lead to a deficiency.

Designing and Performing Monitoring Activities (Ref: par. 38–39)

A149. The firm’s monitoring activities may comprise a combination of ongoing monitoring activities and periodic monitoring activities. Ongoing monitoring activities are generally routine

activities built into the firm's processes and performed on a real-time basis. Periodic monitoring activities are conducted at certain intervals by the firm. In most cases, ongoing monitoring activities provide information about the system of quality management in a timelier manner.

A150. Monitoring activities may include the inspection of in-process engagements. Inspections of engagements are designed to monitor whether an aspect of the system of quality management is designed, implemented, and operating in the manner intended. In some circumstances, the system of quality management may include responses that are designed to review engagements while they are in the process of being performed that appear similar in nature to an inspection of in-process engagements (for example, reviews that are designed to detect failures or shortcomings in the system of quality management so that they can prevent a quality risk from occurring). The purpose of the activity drives its design and implementation and where it fits within the system of quality management (that is, whether it is an inspection of an in-process engagement that is a monitoring activity or a review of an engagement that is a response to address a quality risk).

A151. The nature, timing, and extent of the monitoring activities may also be affected by other matters, including

- the size, structure, and organization of the firm.
- the involvement of the firm's network in monitoring activities.
- the resources that the firm intends to use to enable monitoring activities, such as the use of IT applications.

A152. When performing monitoring activities, the firm may determine that changes to the nature, timing, and extent of the monitoring activities are needed, such as when findings indicate the need for more extensive monitoring activities.

The Design of the Firm's Risk Assessment Process and Monitoring and Remediation Process
(Ref: par. 38c)

A153. How the firm's risk assessment process is designed (for example, a centralized or decentralized process, or the frequency of review) may affect the nature, timing, and extent of the monitoring activities, including monitoring activities over the firm's risk assessment process.

A154. How the firm's monitoring and remediation process is designed (that is, the nature, timing, and extent of the monitoring and remediation activities, taking into account the nature and circumstances of the firm) may affect the monitoring activities undertaken by the firm to determine whether the monitoring and remediation process is achieving the intended purpose as described in paragraph 36.

A155. An example of scalability to demonstrate how the monitoring activities for the monitoring and remediation process may differ in firms of different complexity is as follows:

- In a less complex firm, the monitoring activities may be simple because information about the monitoring and remediation process may be readily available in the form of leadership's knowledge, based on their frequent interaction with the system of quality management, of the nature, timing, and extent of the monitoring activities undertaken, the results of the monitoring activities, and the firm's actions to address the results.

- In a more complex firm, the monitoring activities for the monitoring and remediation process may be specifically designed to determine that the monitoring and remediation process is providing relevant, reliable, and timely information about the system of quality management, and responding appropriately to identified deficiencies.

Changes in the System of Quality Management (Ref: par. 38d)

A156. Changes in the system of quality management may include

- changes to address an identified deficiency in the system of quality management.
- changes to the quality objectives, quality risks, or responses as a result of changes in the nature and circumstances of the firm and its engagements.

When changes occur, previous monitoring activities undertaken by the firm may no longer provide the firm with information to support the evaluation of the system of quality management and, therefore, the firm's monitoring activities may include monitoring of those areas of change.

Previous Monitoring Activities (Ref: par. 38e and 44b)

A157. The results of the firm's previous monitoring activities may indicate areas of the system where a deficiency may arise, particularly areas where there is a history of identified deficiencies.

A158. Previous monitoring activities undertaken by the firm may no longer provide the firm with information to support the evaluation of the system, including on areas of the system of quality management that have not changed, particularly when time has elapsed since the monitoring activities were undertaken.

Other Relevant Information (Ref: par. 17h and 38f)

A159. In addition to the sources of information indicated in paragraph 38f, other relevant information may include the following:

- Information communicated by the firm's network in accordance with paragraphs 51c and 52b about the firm's system of quality management, including the network requirements or network services that the firm has included in its system of quality management
- Information communicated by a service provider about the resources the firm uses in its system of quality management
- Information from regulators about the entities for whom the firm performs engagements, which is made available to the firm, such as information from a securities regulator about an entity for whom the firm performs engagements (for example, irregularities in the entity's financial statements)

A160. The results of external inspections or other relevant information, both internal and external, may indicate that previous monitoring activities undertaken by the firm failed to identify a deficiency in the system of quality management. This information may affect the firm's consideration of the nature, timing, and extent of the monitoring activities.

A161. External inspections are not a substitute for the firm’s internal monitoring activities. Nevertheless, the results of external inspections inform the nature, timing, and extent of the monitoring activities.

Engagement Inspections (Ref: par. 39)

A162. Examples of matters in paragraph 38 that may be considered by the firm in selecting completed engagements for inspection include the following:

- In relation to the conditions, events, circumstances, actions, or inactions giving rise to the quality risks:
 - The types of engagements performed by the firm, and the extent of the firm’s experience in performing the type of engagement
 - The types of entities for which engagements are undertaken, for example:
 - Entities operating in emerging industries
 - Entities operating in industries associated with a high level of complexity or judgment
 - Entities operating in an industry that is new to the firm
 - The tenure and experience of engagement partners
- The results of previous inspections of completed engagements, including for each engagement partner
- In relation to other relevant information:
 - Complaints or allegations about an engagement partner
 - The results of external inspections, including for each engagement partner
 - The results of the firm’s evaluation of each engagement partner’s commitment to quality

A163. The firm may undertake multiple monitoring activities, other than inspection of completed engagements, that focus on determining whether engagements have complied with policies or procedures. These monitoring activities may be undertaken on certain engagements or engagement partners. The nature and extent of these monitoring activities, and the results, may be used by the firm in determining the following:

- How often to select completed engagements to select for inspection, and which completed engagements to select, based on the factors described in paragraph A159
- Which engagement partners to select for inspection, and how frequently to select an engagement partner for inspection, based on factors such as how long it has been since the engagement partner was subject to inspection, the results of previous inspections of the engagement partner, or the engagement partner’s experience with performing engagements at different levels of service, in new industries, or with complex financial reporting matters
- Which aspects of the engagement to consider when performing the inspection of completed engagements

For example, if the firm has undertaken inspections of in-process engagements

- the firm may determine it appropriate to reduce the extent of selection of completed engagements for inspection;
- the results of the inspections of in-process engagements may indicate areas of risk that may affect which completed engagements are selected for inspection; or
- the results of the inspections of in-process engagements may identify negative quality issues that prompt the firm to shorten the inspection cycle or expand the extent of completed engagement inspections.

A164. The inspection of completed engagements for engagement partners on a cyclical basis may assist the firm in monitoring whether engagement partners have fulfilled their overall responsibility for managing and achieving quality on the engagements to which they are assigned.

A165. Examples of policies and procedures that a firm may establish to apply a cyclical basis for the inspection of completed engagements for each engagement partner include the following policies or procedures that

- set forth the standard period of the inspection cycle, such as the inspection of a completed engagement for each engagement partner performing audits of financial statements once every three years, and for all other engagement partners, once every five years.
- set out the criteria for selecting completed engagements, including that for an engagement partner performing audits of financial statements, the engagements selected include an audit engagement.
- address the selection of engagement partners in a manner that is unpredictable.
- address when it is necessary or appropriate to select engagement partners more, or less, frequently than the standard period set out in the policy. Examples follow:
 - The firm may select engagement partners more frequently than the standard period set out in the firm's policy when
 - multiple deficiencies have been identified by the firm that have been evaluated as severe, and the firm determines that a more frequent cyclical inspection is needed across all engagement partners.
 - the engagement partner performs engagements for entities operating in a certain industry in which there are high levels of complexity or judgment.
 - an engagement performed by the engagement partner has been subject to other monitoring activities, and the results of the other monitoring activities were unsatisfactory.
 - the engagement partner has performed an engagement for an entity operating in an industry in which the engagement partner has limited experience.
 - the engagement partner has limited experience in performing that level of service engagements.
 - the engagement partner is a newly appointed engagement partner or has recently joined the firm from another firm or another jurisdiction.

- The firm may defer the selection of the engagement partner (for example, deferring for a year beyond the standard period set out in the firm’s policy) when
 - engagements performed by the engagement partner have been subject to other monitoring activities during the standard period set out in the firm’s policy, and
 - the results of the other monitoring activities provide sufficient information about the engagement partner, that is, performing the inspection of completed engagements would unlikely provide the firm with further information about the engagement partner.

A166. The matters considered in an inspection of an engagement depend on how the inspection will be used to monitor the system of quality management. Ordinarily, the inspection of an engagement includes determining that responses that are implemented at the engagement level (for example, the firm’s policies and procedures in respect of engagement performance) have been implemented as designed and are operating effectively.

The Relationship of Peer Review to Monitoring

A167. A peer review is not a substitute for all monitoring procedures. However, because the objective of a peer review is similar to that of inspection procedures, a firm’s quality control policies and procedures may provide that a peer review conducted under standards established by the AICPA may be a substitute for the inspection of engagement documentation, reports, and clients’ financial statements for some or all engagements for the period covered by the peer review.

Individuals Performing the Monitoring Activities (Ref: par. 40b)

A168. The provisions of relevant ethical requirements are relevant in designing the policies or procedures addressing the objectivity of the individuals performing the monitoring activities. A self-review threat may arise when an individual who performs

- an inspection of an engagement was
 - in the case of an audit of financial statements, an engagement team member or the engagement quality reviewer of that engagement or an engagement for a subsequent financial period, or
 - for all other engagements, an engagement team member or the engagement quality reviewer of that engagement.
- another type of monitoring activity participated in designing, executing, or operating the response being monitored.

A169. In some circumstances, for example, in the case of a less complex firm, there may not be personnel who have the competence, capabilities, time, or objectivity to perform the monitoring activities. In these circumstances, the firm may use network services or a service provider to perform the monitoring activities.

Evaluating Findings and Identifying Deficiencies (Ref: par. 17a and 41–42)

A170. The firm accumulates findings from the performance of monitoring activities, external inspections, and other relevant sources. Information accumulated by the firm from the monitoring

activities, external inspections, and other relevant sources may reveal other observations about the firm's system of quality management, such as

- actions, behaviors, or conditions that have given rise to positive outcomes in the context of quality or the effectiveness of the system of quality management, or
- similar circumstances in which no findings were noted (for example, engagements in which no findings were noted, and the engagements have a similar nature to the engagements in which findings were noted).

Other observations may be useful to the firm because they may assist the firm in investigating the root causes of identified deficiencies, indicate practices that the firm can support or apply more extensively (for example, across all engagements), or highlight opportunities for the firm to enhance the system of quality management.

A171. The firm exercises professional judgment in determining whether findings, individually or in combination with other findings, give rise to a deficiency in the system of quality management. In making the judgment, the firm may need to take into account the relative importance of the findings in the context of the quality objectives, quality risks, responses, or other aspects of the system of quality management to which they relate. The firm's judgments may be affected by quantitative and qualitative factors relevant to the findings. In some circumstances, the firm may determine it appropriate to obtain more information about the findings in order to determine whether a deficiency exists. Not all findings, including engagement findings, will be a deficiency.

A172. Examples of quantitative and qualitative factors that a firm may consider in determining whether findings give rise to a deficiency include the following:

Quality risks and responses

- If the findings relate to a response:
 - How the response is designed, for example, the nature of the response, the frequency of its occurrence (if applicable), and the relative importance of the response to addressing the quality risks and achieving the quality objectives to which it relates
 - The nature of the quality risk to which the response relates and the extent to which the findings indicate that the quality risk has not been addressed
 - Whether there are other responses that address the same quality risk and whether there are findings for those responses

Nature of the findings and their pervasiveness

- The nature of the findings. For example, findings related to leadership actions and behaviors may be qualitatively significant, given the pervasive effect this could have on the system of quality management as a whole.
- Whether the findings, in combination with other findings, indicate a trend or systemic issue. For example, similar engagement findings that appear on multiple engagements may indicate a systemic issue.

Extent of Monitoring Activity and Extent of Findings

- The extent of the monitoring activity from which the findings arose, including the number or size of the selections.
- The extent of the findings in relation to the selection covered by the monitoring activity and in relation to the expected deviation rate. For example, in the case of inspection of engagements, the number of engagements selected in which the findings were identified, relative to the total number of engagements selected, and the expected deviation rate set by the firm.

A173. Evaluating findings and identifying deficiencies and evaluating the severity and pervasiveness of an identified deficiency, including investigating the root causes of an identified deficiency, are part of an iterative and nonlinear process. Examples follows:

- In investigating the root causes of an identified deficiency, the firm may identify a circumstance that has similarities to other circumstances in which there were findings that were not considered deficiencies. As a result, the firm adjusts its evaluation of the other findings and classifies them as deficiencies.
- In evaluating the severity and pervasiveness of an identified deficiency, the firm may identify a trend or systemic issue that correlates with other findings that are not considered deficiencies. As a result, the firm adjusts its evaluation of the other findings and also classifies them as deficiencies.

A174. The results of monitoring activities, results of external inspections, and other relevant information (for example, network monitoring activities or complaints and allegations) may reveal information about the effectiveness of the monitoring and remediation process. For example, the results of external inspections may provide information about the system of quality management that has not been identified by the firm’s monitoring and remediation process, which may highlight a deficiency in that process.

Evaluating Identified Deficiencies (Ref: par. 42)

A175. Factors the firm may consider in evaluating the severity and pervasiveness of an identified deficiency include the following:

- The nature of the identified deficiency, including the aspect of the firm’s system of quality management to which the deficiency relates, and whether the deficiency is in the design, implementation, or operation of the system of quality management
- In the case of identified deficiencies related to responses, whether there are compensating responses to address the quality risk to which the response relates
- The root causes of the identified deficiency
- The frequency with which the matter giving rise to the identified deficiency occurred
- The magnitude of the identified deficiency, how quickly it occurred, and the duration of time that it existed and had an effect on the system of quality management

A176. The severity and pervasiveness of identified deficiencies affects the evaluation of the system of quality management that is undertaken by the individuals assigned ultimate responsibility and accountability for the system of quality management.

Root Cause of the Identified Deficiencies (Ref: par. 42a)

A177. The objective of investigating the root causes of identified deficiencies is to understand the underlying circumstances that caused the deficiencies to enable the firm to

- evaluate the severity and pervasiveness of the identified deficiency and
- appropriately remediate the identified deficiency.

Performing a root cause analysis involves the exercise of professional judgment based on the evidence available by those performing the assessment.

A178. The nature, timing, and extent of the procedures undertaken to understand the root causes of an identified deficiency may also be affected by the nature and circumstances of the firm, such as the following:

- The complexity and operating characteristics of the firm.
- The size of the firm.
- The geographical dispersion of the firm.
- How the firm is structured or the extent to which the firm concentrates or centralizes its processes or activities. For example, in the case of a less complex firm with a single location, the firm's procedures to understand the root causes of a deficiency may be simple because the information to inform the understanding may be readily available and concentrated, and the root causes may be more apparent. In the case of a more complex firm with multiple locations, the procedures to understand the root causes of a deficiency may include using individuals specifically trained on investigating the root causes of identified deficiencies and developing a methodology with more formalized procedures for identifying root causes.
- The nature of the identified deficiency, for example, the firm's procedures to understand the root causes of an identified deficiency may be more rigorous in circumstances when an engagement report related to an audit of financial statements was issued that was inappropriate, or the identified deficiency relates to leadership's actions and behaviors regarding quality.
- The possible severity of the identified deficiency, for example, the firm's procedures to understand the root causes of an identified deficiency may be more rigorous in circumstances when the deficiency has been identified across multiple engagements, or there is an indication that policies or procedures have high rates of noncompliance.

A179. In investigating the root causes of identified deficiencies, the firm may consider why deficiencies did not arise in other circumstances that are of a similar nature to the matter to which the identified deficiency relates. Such information may also be useful in determining how to remediate an identified deficiency. For example, the firm may determine that a deficiency exists because similar findings have occurred across multiple engagements. However, the findings have not occurred in several other engagements within the same population being tested. By contrasting the engagements, the firm concludes that the root cause of the identified deficiency is a lack of appropriate involvement by the engagement partners at key stages of the engagements.

A180. Identifying root causes that are appropriately specific may support the firm’s process for remediating identified deficiencies. For example, the firm may identify that engagement teams performing audits of financial statements are failing to obtain sufficient appropriate audit evidence on accounting estimates when management’s assumptions have a high degree of subjectivity. Although the firm notes that these engagement teams are not exercising appropriate professional skepticism, the underlying root cause of this issue may relate to another matter, such as a cultural environment that does not encourage engagement team members to question individuals with greater authority or insufficient direction, supervision, and review of the work performed on the engagements.

A181. In addition to investigating the root causes of identified deficiencies, the firm may also investigate the root causes of positive outcomes because doing so may reveal opportunities for the firm to improve, or further enhance, the system of quality management.

Responding to Identified Deficiencies (Ref: par. 43)

A182. The nature, timing, and extent of remedial actions may depend on a variety of other factors, including the following:

- The root causes
- The severity and pervasiveness of the identified deficiency and, therefore, the urgency with which it needs to be addressed
- The effectiveness of the remedial actions in addressing the root causes, such as whether the firm needs to implement more than one remedial action in order to effectively address the root causes, or needs to implement remedial actions as interim measures until the firm is able to implement more effective remedial actions

A183. In some circumstances, the remedial action may include establishing additional quality objectives, or quality risks or responses may be added or modified, because it is determined that they are not appropriate.

A184. In circumstances when the firm determines that the root cause of an identified deficiency relates to a resource provided by a service provider, the firm may also

- consider whether to continue using the resource provided by the service provider.
- communicate the matter to the service provider.

The firm is responsible for addressing the effect of the identified deficiency related to a resource provided by a service provider on the system of quality management and taking action to prevent the deficiency from recurring with respect to the firm’s system of quality management. However, the firm is not ordinarily responsible for remediating the identified deficiency on behalf of the service provider or further investigating the root cause of the identified deficiency at the service provider.

Findings About a Particular Engagement (Ref: par. 46)

A185. AU-C section 585, *Consideration of Omitted Procedures After the Report Release Date*, addresses the auditor’s responsibilities in circumstances when procedures were omitted, or the report issued is inappropriate. In such circumstances relating to other assurance and attest engagements, the action taken by the firm may include the following:

- Consulting with appropriate individuals regarding the appropriate action

- Discussing the matter with management of the entity or those charged with governance
- Performing the omitted procedures

The actions taken by the firm do not relieve the firm of the responsibility to take further actions relating to the finding in the context of the system of quality management, including evaluating the findings to identify deficiencies and, when a deficiency exists, investigating the root causes of the identified deficiency.

Ongoing Communication Related to the Monitoring and Remediation (Ref: par. 47)

A186. The information communicated about the monitoring and remediation to the individuals assigned ultimate responsibility and accountability for the system of quality management may be communicated on an ongoing basis or periodically. The individuals may use the information in multiple ways. Examples follow:

- As a basis for further communications to personnel about the importance of quality
- To hold individuals accountable for their roles assigned to them
- To identify key concerns about the system of quality management in a timely manner

The information also provides a basis for the evaluation of the system of quality management, and conclusion thereon, as required by paragraphs 54–56.

Network Requirements or Network Services (Ref: par. 49)

A187. In some circumstances, the firm may belong to a network. Networks may establish requirements regarding the firm’s system of quality management or may make services or resources available that the firm may choose to implement or use in the design, implementation, and operation of its system of quality management. Such requirements or services may be intended to promote the consistent performance of quality engagements across the firms that belong to the network. The extent to which the network will provide the firm with quality objectives, quality risks, and responses that are common across the network will depend on the firm’s arrangements with the network.

A188. Examples of network requirements include the following:

- Requirements for the firm to include additional quality objectives or quality risks in the firm’s system of quality management that are common across the network firms.
- Requirements for the firm to include responses in the firm’s system of quality management that are common across the network firms. Such responses designed by the network may include network policies or procedures that specify the leadership roles and responsibilities, including how the firm is expected to assign authority and responsibility within the firm, or resources, such as network-developed methodologies for performing engagements or IT applications.
- Requirements that the firm be subject to the network’s monitoring activities. These monitoring activities may relate to network requirements (for example, monitoring that the firm has implemented the network’s methodology appropriately) or to the firm’s system of quality management in general.

A189. Examples of network services include services or resources that are optional for the firm to use in its system of quality management or in performing engagements, such as voluntary training programs, use of component auditors or experts from within the network, or use of a service delivery center established at the network level, or by another network firm or group of network firms.

A190. The network may establish responsibilities for the firm in implementing the network requirements or network services. Examples follow:

- The firm is required to have certain IT infrastructure and IT processes in place to support an IT application provided by the network that the firm uses in the system of quality management.
- The firm is required to provide firm-wide training on the methodology provided by the network, including when updates are made to the methodology.

A191. The firm's understanding of the network requirements or network services and the firm's responsibilities relating to the implementation thereof may be obtained through inquiries of, or documentation provided by, the network about matters such as the following:

- The network's governance and leadership
- The procedures undertaken by the network in designing, implementing, and, if applicable, operating, the network requirements or network services
- How the network identifies and responds to changes that affect the network requirements or network services or other information, such as changes in the professional standards or information that indicates a deficiency in the network requirements or network services
- How the network monitors the appropriateness of the network requirements or network services, which may include through the network firms' monitoring activities, and the network's processes for remediating identified deficiencies

Network Requirements or Network Services in the Firm's System of Quality Management
(Ref: par. 50)

A192. The characteristics of the network requirements or network services are a condition, event, circumstance, action, or inaction in identifying and assessing quality risks. An example of a network requirement or network service that gives rise to a quality risk is as follows.

The network may require the firm to use an IT application for the acceptance and continuance of client relationships and specific engagements that is standardized across the network. This may give rise to a quality risk that the IT application does not address matters in local law or regulation that need to be considered by the firm in accepting and continuing client relationships and specific engagements.

A193. The purpose of the network requirements may include the promotion of consistent performance of quality engagements across the network firms. The firm may be expected by the network to implement the network requirements; however, the firm may need to adapt or supplement the network requirements such that they are appropriate for the nature and circumstances of the firm and its engagements.

A194. Examples of how the network requirements or networks services may need to be adapted or supplemented include the following:

<i>Network requirement or network service</i>	<i>How the firm adapts or supplements the network requirement or network service</i>
<p>The network requires the firm to include certain quality risks in the system of quality management, so that all firms in the network address the quality risks. The network does not provide an assessment of the quality risks.</p>	<p>As part of identifying and assessing quality risks, the firm assesses the quality risks that are required by the network.</p> <p>The firm also designs and implements responses to address the assessed quality risks that are required by the network.</p>
<p>The network requires that the firm design and implement certain responses.</p>	<p>As part of designing and implementing responses, the firm determines</p> <ul style="list-style-type: none"> • which assessed quality risks the responses address. • how the responses required by the network will be incorporated into the firm’s system of quality management, given the nature and circumstances of the firm. This may include tailoring the response to reflect the nature and circumstances of the firm and the engagements performed by the firm (for example, tailoring a methodology to include matters related to law or regulation).

A195. In some circumstances, in adapting or supplementing the network requirements or network services, the firm may identify possible improvements to the network requirements or network services and may communicate these improvements to the network.

Monitoring Activities Undertaken by the Network on the Firm’s System of Quality Management (Ref: par. 51c)

A196. The results of the network’s monitoring activities of the firm’s system of quality management may include information such as the following:

- A description of the monitoring activities, including their nature, timing, and extent
- Findings, identified deficiencies, and other observations about the firm’s system of quality management (for example, positive outcomes or opportunities for the firm to improve, or further enhance, the system of quality management)
- The network’s evaluation of the root causes of the identified deficiencies, the assessed effect of the identified deficiencies, and recommended remedial actions

Monitoring Activities Undertaken by the Network Across the Network Firms (Ref: par. 52b)

A197. The information from the network about the overall results of the network’s monitoring activities undertaken across the network firms’ systems of quality management may be an aggregation or summary of the information described in paragraph A193, including trends and common areas of identified deficiencies across the network, or positive outcomes that may be replicated across the network. Such information may

- be used by the firm
 - in identifying and assessing quality risks.
 - as part of other relevant information considered by the firm in determining whether deficiencies exist in the network requirements or network services used by the firm in its system of quality management.
- be communicated to group engagement partners, in the context of considering the competence and capabilities of component auditors from a network firm who are subject to common network requirements (for example, common quality objectives, quality risks, and responses).

A198. In some circumstances, the firm may obtain information from the network about deficiencies identified in a network firm’s system of quality management that affects the firm. The network may also gather information from network firms regarding the results of external inspections over network firms’ systems of quality management. In some instances, law or regulation in a particular jurisdiction may prevent the network from sharing information with other network firms or may restrict the specificity of such information.

A199. In circumstances when the network does not provide the information about the overall results of the network’s monitoring activities across the network firms, the firm may take further actions, such as

- discussing the matter with the network, and
- determining the effect on the firm’s engagements and communicating the effect to engagement teams.

Deficiencies in Network Requirements or Network Services Identified by the Firm (Ref: par. 53)

A200. As network requirements or network services used by the firm form part of the firm's system of quality management, they are also subject to the requirements of this proposed SQMS regarding monitoring and remediation. The network requirements or network services may be monitored by the network, the firm, or a combination of both; for example, a network may undertake monitoring activities at a network level for a common methodology. The firm may also monitor the application of the methodology by engagement team members through performing engagement inspections.

A201. In designing and implementing the remedial actions to address the effect of the identified deficiency in the network requirements or network services, the firm may

- understand the planned remedial actions by the network, including whether the firm has any responsibilities for implementing the remedial actions, and
- consider whether supplementary remedial actions need to be taken by the firm to address the identified deficiency and the related root causes, such as when
 - the network has not taken appropriate remedial actions, or
 - the network's remedial actions will take time to effectively address the identified deficiency.

Evaluating the System of Quality Management (Ref: par. 54)

A202. The individuals assigned ultimate responsibility and accountability for the system of quality management may be assisted by other individuals in performing the evaluation. Nevertheless, the individuals assigned ultimate responsibility and accountability for the system of quality management remain responsible and accountable for the evaluation.

A203. The point in time at which the evaluation is undertaken may depend on the circumstances of the firm and may coincide with the fiscal year-end of the firm or the completion of an annual monitoring cycle.

A204. The information that provides the basis for the evaluation of the system of quality management includes the information communicated to the individuals assigned ultimate responsibility and accountability for the system of quality management in accordance with paragraph 47.

A205. An example of scalability to demonstrate how the information that provides the basis for the evaluation of the system of quality management may be obtained in firms of different complexity is as follows:

- In a less complex firm, the individuals assigned ultimate responsibility and accountability for the system of quality management may be directly involved in the monitoring and remediation and, therefore, will be aware of the information that supports the evaluation of the system of quality management.
- In a more complex firm, the individuals assigned ultimate responsibility and accountability for the system of quality management may need to establish processes to collate, summarize, and communicate the information needed to evaluate the system of quality management.

Concluding on the System of Quality Management (Ref: par. 55)

A206. In the context of this proposed SQMS, it is intended that the operation of the system as a whole provides the firm with reasonable assurance that the objectives of the system of quality management are being achieved. In concluding on the system of quality management, the individuals assigned ultimate responsibility and accountability for the system of quality management may, in using the results of the monitoring and remediation process, consider the following:

- The severity and pervasiveness of identified deficiencies and the effect on the achievement of the objectives of the system of quality management
- Whether remedial actions have been designed and implemented by the firm and whether the remedial actions taken up to the time of the evaluation are effective
- Whether the effect of identified deficiencies on the system of quality management have been appropriately corrected, such as whether further actions have been taken in accordance with paragraph 46

A207. There may be circumstances when identified deficiencies that are severe (including identified deficiencies that are severe and pervasive) have been appropriately remediated and the effect of them corrected at the point in time of the evaluation. In such cases, the individuals assigned ultimate responsibility and accountability for the system of quality management may conclude that the system of quality management provides the firm with reasonable assurance that the objectives of the system of quality management are being achieved.

A208. An identified deficiency may have a pervasive effect on the design, implementation, and operation of the system of quality management when, for example

- the deficiency affects several components or aspects of the system of quality management.
- the deficiency is confined to a specific component or aspect of the system of quality management but is fundamental to the system of quality management.
- the deficiency affects several business units or geographical locations of the firm.
- the deficiency is confined to a business unit or geographical location, but the business unit or location affected is fundamental to the firm overall.
- the deficiency affects a substantial portion of engagements that are of a certain type or nature.

A209. An example of an identified deficiency that may be considered severe but not pervasive is as follows:

The firm identifies a deficiency in one of its smaller regional offices. The identified deficiency relates to noncompliance with many firm policies or procedures. The firm determines that the culture in the regional office, particularly the actions and behavior of leadership in the regional office, which were overly focused on financial priorities, has contributed to the root cause of the identified deficiency. The firm determines that the effect of the identified deficiency is as follows:

- Severe, because it relates to the culture of the regional office and overall compliance with firm policies or procedures
- Not pervasive, because it is limited to the smaller regional office

A210. The individuals assigned ultimate responsibility and accountability for the system of quality management may conclude that the system of quality management does not provide the firm with reasonable assurance that the objectives of the system of quality management are being achieved in circumstances when identified deficiencies are severe and pervasive, actions taken to remediate the identified deficiencies are not appropriate, and the effect of the identified deficiencies have not been appropriately corrected.

A211. An example of an identified deficiency that may be considered severe and pervasive is as follows:

The firm identifies a deficiency in a regional office, which is the firm’s largest office and provides financial, operational, and technical support for the entire region. The identified deficiency relates to noncompliance with many firm policies or procedures. The firm determines that the culture in the regional office, particularly the actions and behavior of leadership in the regional office, which were overly focused on financial priorities, has contributed to the root cause of the identified deficiency. The firm determines that the effect of the identified deficiency is as follows:

- Severe, because it relates to the culture of the regional office and overall compliance with firm policies or procedures
- Pervasive, because the regional office is the largest office and provides support to many other offices, and the noncompliance with firm policies or procedures may have had a broader effect on the other offices

A212. It may take time for the firm to remediate identified deficiencies that are severe and pervasive. As the firm continues to take action to remediate the identified deficiencies, the pervasiveness of the identified deficiencies may be diminished, and it may be determined that the identified deficiencies are still severe but no longer severe and pervasive. In such cases, the individuals assigned ultimate responsibility and accountability for the system of quality management may conclude that, except for matters related to identified deficiencies that have a severe but not pervasive effect on the design, implementation, and operation of the system of quality management, the system of quality management provides the firm with reasonable assurance that the objectives of the system of quality management are being achieved.

A213. This proposed SQMS does not require the firm to obtain an independent assurance report on its system of quality management or preclude the firm from doing so.

Taking Prompt and Appropriate Action and Further Communication (Ref: par. 56)

A214. In circumstances when the individuals assigned ultimate responsibility and accountability for the system of quality management reach the conclusion described in paragraph 54*b* or 54*c*, the prompt and appropriate action taken by the firm may include the following:

- Taking measures to support performing engagements through assigning more resources or developing more guidance and to confirm that reports issued by the firm are appropriate in the circumstances, until such time as the identified deficiencies are remediated, and communicating such measures to engagement teams

- Obtaining legal advice

A215. In some circumstances, the firm may have an independent governing body that has nonexecutive oversight of the firm. In such circumstances, communications may include informing the independent governing body.

A216. Examples of circumstances in which it may be appropriate for the firm to communicate to external parties about the evaluation of the system of quality management include the following:

- When the firm belongs to a network
- When other network firms use the work performed by the firm, for example, in the case of a group audit
- When a report issued by the firm is determined by the firm to be inappropriate as a result of the failure of the system of quality management, and management or those charged with governance of the entity need to be informed
- When law or regulation requires the firm to communicate to an oversight authority or a regulatory body

Performance Evaluations (Ref: par. 57)

A217. Periodic performance evaluations promote accountability. In considering the performance of an individual, the firm may take the following into account:

- The results of the firm's monitoring activities for aspects of the system of quality management that relate to the responsibility of the individual. In some circumstances, the firm may set targets for the individual and measure the results of the firm's monitoring activities against those targets.
- The actions taken by the individual in response to identified deficiencies that relate to the responsibility of that individual, including the timeliness and effectiveness of such actions.

A218. An example of scalability to demonstrate how firms of different complexity may undertake the performance evaluations is as follows:

- In a less complex firm, the firm may engage a service provider to perform the evaluation, or the results of the firm's monitoring activities may provide an indication of the performance of the individual.
- In a more complex firm, the performance evaluations may be undertaken by an independent nonexecutive member of the firm's governing body or a special committee overseen by the firm's governing body.

A219. A positive performance evaluation may be rewarded through compensation, promotion, and other incentives that focus on the individual's commitment to quality and reinforce accountability. On the other hand, the firm may take corrective actions to address a negative performance evaluation that may affect the firm's achievement of its quality objectives.

Documentation (Ref: par. 58–60)

A220. Documentation provides evidence that the firm complies with this proposed SQMS, as well as law, regulation, or relevant ethical requirements. It may also be useful for training personnel and engagement teams, ensuring the retention of organizational knowledge, and providing a history of the basis for decisions made by the firm about its system of quality management. It is neither necessary nor practicable for the firm to document every matter considered, or judgment made, about its system of quality management. Furthermore, compliance with this proposed SQMS may be evidenced by the firm through its information and communication component, documents or other written materials, or IT applications that are integral to the components of the system of quality management.

A221. Documentation may be formal (for example, written manuals, checklists, and forms), informal (for example, email communication or postings on websites), or held in IT applications or other digital forms (for example, in databases). Factors that may affect the firm's judgments about the form, content, and extent of documentation, including how often documentation is updated, may include the following:

- The complexity of the firm and the number of offices
- The nature and complexity of the firm's practice and organization
- The nature of engagements the firm performs and the nature of the entities for whom engagements are performed
- The nature and complexity of the matter being documented, such as whether it relates to an aspect of the system of quality management that has changed or an area of greater quality risk, and the complexity of the judgments relating to the matter
- The frequency and extent of changes in the system of quality management

In a less complex firm, it may not be necessary to have documentation supporting matters communicated because informal communication methods may be effective. Nevertheless, a less complex firm may determine it appropriate to document such communications in order to provide evidence that they occurred.

A222. In some instances, an external oversight authority may establish documentation requirements, either formally or informally, for example, as a result of the outcome of external inspection findings. Relevant ethical requirements may also include specific requirements addressing documentation, for example, the AICPA code requires documentation of particular matters, including certain situations related to conflicts of interest, noncompliance with laws and regulations, and independence.

A223. The firm is not required to document the consideration of every condition, event, circumstance, action, or inaction for each quality objective or each risk that may give rise to a quality risk. However, in documenting the quality risks and how the firm's responses address the quality risks, the firm may document the reasons for the assessment given to the quality risks (that is, the considered occurrence and effect on the achievement of one or more quality objectives) to support the consistent implementation and operation of the responses.

A224. The documentation may be provided by the network, other network firms, or other structures or organizations within the network.

Proposed Statement on Quality Management Standards *Engagement Quality Reviews*

Introduction

Scope of This Proposed Statement on Quality Management Standards

1. This proposed Statement on Quality Management Standards (SQMS) addresses the following:
 - a. The appointment and eligibility of the engagement quality reviewer
 - b. The engagement quality reviewer's responsibilities relating to the performance and documentation of an engagement quality review
2. This proposed SQMS applies to all engagements for which an engagement quality review is required to be performed in accordance with proposed SQMS *A Firm's System of Quality Management*, including when the firm has determined that an engagement quality review is an appropriate response to assessed quality risks.¹ This proposed SQMS is to be read in conjunction with the AICPA Code of Professional Conduct (AICPA code) and other relevant ethical requirements.
3. An engagement quality review performed in accordance with this proposed SQMS is a specified response that is designed and implemented by the firm in accordance with proposed SQMS *A Firm's System of Quality Management*.² The performance of an engagement quality review is undertaken at the engagement level by the engagement quality reviewer on behalf of the firm.

Scalability

4. The nature, timing, and extent of the engagement quality reviewer's procedures required by this proposed SQMS vary depending on the nature and circumstances of the engagement or the entity. For example, for engagements involving fewer significant judgments made by the engagement team, the engagement quality reviewer's procedures would likely be less extensive.

The Firm's System of Quality Management and Role of Engagement Quality Reviews

5. Proposed SQMS *A Firm's System of Quality Management* establishes the firm's responsibilities for its system of quality management and requires the firm to design and implement responses to address the quality risks in a manner that is based on, and responsive to, the reasons for the assessments given to the quality risks.³ The specified responses in proposed SQMS *A Firm's System of Quality Management*⁴ include establishing policies or

¹ Paragraph 35f of proposed Statement on Quality Management Standards (SQMS) (Previously Statement on Quality Control Standards) *A Firm's System of Quality Management*.

² See footnote 1.

³ Paragraph 25 of proposed SQMS *A Firm's System of Quality Management*.

⁴ Paragraph 35f of proposed SQMS *A Firm's System of Quality Management*.

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procedures addressing engagement quality reviews in accordance with this proposed SQMS.

6. The firm is responsible for designing, implementing, and operating the system of quality management. Under proposed SQMS *A Firm's System of Quality Management*, the objective of the firm is to design, implement, and operate a system of quality management for engagements performed by the firm in its accounting and auditing practice,⁵ which provides the firm with reasonable assurance that
 - the firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements; and
 - engagement reports issued by the firm or engagement partners are appropriate in the circumstances.⁶
7. As explained in proposed SQMS *A Firm's System of Quality Management*, the public interest is served by the consistent performance of quality engagements. Quality engagements are achieved through planning and performing engagements and reporting on them in accordance with professional standards and applicable legal and regulatory requirements. Achieving the objectives of those standards and complying with the requirements of applicable law or regulation involves exercising professional judgment and, when applicable to the type of engagement, exercising professional skepticism.
8. An engagement quality review is an objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon. The engagement quality reviewer's evaluation of significant judgments is performed in the context of professional standards and applicable legal and regulatory requirements. However, an engagement quality review is not intended to be an evaluation of whether the entire engagement complies with professional standards and applicable legal and regulatory requirements or with the firm's policies or procedures.
9. The engagement quality reviewer is not a member of the engagement team. The performance of an engagement quality review does not change the responsibilities of the engagement partner for managing and achieving quality on the engagement or for the direction and supervision of the members of the engagement team and the review of their work. The engagement quality reviewer is not required to obtain evidence to support the opinion or conclusion on the engagement, but the engagement team may obtain further evidence in responding to matters raised during the engagement quality review.

Authority of This Proposed SQMS

10. This proposed SQMS contains the objective for the firm in following this proposed SQMS and requirements designed to enable the firm and the engagement quality reviewer to meet that stated objective. In addition, it contains related guidance in the form of application and other explanatory material and introductory material that provides context relevant to a proper understanding of this proposed SQMS and definitions. Proposed SQMS *A Firm's*

⁵ The term *auditing and accounting practice* is defined in paragraph 17a of proposed SQMS *A Firm's System of Quality Management*.

⁶ Paragraph 15 of proposed SQMS *A Firm's System of Quality Management*.

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*System of Quality Management*⁷ explains the terms *objective*, *requirements*, *application material* and *other explanatory material*, *introductory material*, and *definitions*.

Effective Date

11. This proposed SQMS is effective for
 - a. audits or reviews of financial statements for periods beginning on or after [December 15, 2023]*, and
 - b. other engagements in the firm’s accounting and auditing practice beginning on or after [December 15, 2023].*

Objective

12. The objective of the firm, through appointing an eligible engagement quality reviewer, is to perform an objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon.

Definitions

13. For purposes of the SQMSs, the following terms have the meanings attributed as follows:

Engagement quality review. An objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon, performed by the engagement quality reviewer and completed on or before the date of the engagement report.

Engagement quality reviewer. A partner, other individual in the firm, or an external individual appointed by the firm to perform the engagement quality review.

Relevant ethical requirements. Principles of professional ethics and ethical requirements to which the engagement team and engagement quality reviewer, when undertaking an engagement quality review, are subject, which consist of the AICPA Code of Professional Conduct together with rules of applicable state boards of accountancy and applicable regulatory agencies that are more restrictive. (Ref: par. A11–A14)

Requirements

Applying, and Complying With, Relevant Requirements

14. The firm and the engagement quality reviewer should have an understanding of this proposed SQMS, including the application and other explanatory material, to understand the objective of this SQMS and to properly apply the requirements relevant to them.

⁷ Paragraph 12 and A6–A9 of proposed SQMS *A Firm’s System of Quality Management*.

* This date is provisional but will not be earlier than December 15, 2023.

* This date is provisional but will not be earlier than December 15, 2023.

Proposed SQMS *Engagement Quality Reviews*

15. The firm or the engagement quality reviewer, as applicable, should comply with each requirement of this proposed SQMS, unless the requirement is not relevant in the circumstances of the engagement.
16. The proper application of the requirements is expected to provide a sufficient basis for the achievement of the objective of this proposed standard. However, if the firm or the engagement quality reviewer determines that the application of the relevant requirements does not provide a sufficient basis for the achievement of the objective of this proposed standard, the firm or the engagement quality reviewer, as applicable, should take further actions to achieve the objective.

Appointment and Eligibility of Engagement Quality Reviewers

17. The firm should establish policies or procedures that require the assignment of responsibility for the appointment of engagement quality reviewers to individuals with the competence, capabilities, and appropriate authority within the firm to fulfill the responsibility. Those policies or procedures should require such individuals to appoint the engagement quality reviewer. (Ref: par. A1–A3)
18. The firm should establish policies or procedures that set forth the criteria for eligibility to be appointed as an engagement quality reviewer. Those policies or procedures should require that the engagement quality reviewer not be a member of the engagement team and (Ref: par. A4)
 - a. has the competence and capabilities, including sufficient time, and the appropriate authority to perform the engagement quality review, (Ref: par. A5–A10)
 - b. complies with relevant ethical requirements, including those addressing threats to the objectivity and independence of the engagement quality reviewer, and (Ref: par. A11–A14)
 - c. complies with provisions of law and regulation, if any, that are relevant to the eligibility of the engagement quality reviewer. (Ref: par. A15)
19. The firm’s policies or procedures established in accordance with paragraph 18*b* should also address threats to objectivity created by an individual being appointed as the engagement quality reviewer after previously serving as the engagement partner. Such policies or procedures should specify a cooling-off period of two years, or a longer period if required by relevant ethical requirements, before the engagement partner can assume the role of engagement quality reviewer. (Ref: par. A16–A17)
20. The firm should establish policies or procedures that set forth the criteria for eligibility of individuals who assist the engagement quality reviewer. Those policies or procedures should require that such individuals not be members of the engagement team and
 - a. have the competence and capabilities, including sufficient time, to perform the duties assigned to them, and (Ref: par. A18)
 - b. comply with relevant ethical requirements, including addressing threats to their objectivity and independence and, if applicable, the provisions of law and regulation. (Ref: par. A19–A20)

21. The firm should establish policies or procedures that
 - a. require the engagement quality reviewer to take overall responsibility for the performance of the engagement quality review, and
 - b. address the engagement quality reviewer's responsibility for determining the nature, timing, and extent of the direction and supervision of the individuals assisting in the engagement quality review and the review of their work. (Ref: par. A21)

Impairment of the Engagement Quality Reviewer's Eligibility to Perform the Engagement Quality Review

22. The firm should establish policies or procedures that address circumstances in which the engagement quality reviewer's eligibility to perform the engagement quality review is impaired and the appropriate actions to be taken by the firm, including the process for identifying and appointing a replacement in such circumstances. (Ref: par. A22)
23. When the engagement quality reviewer becomes aware of circumstances that impair the engagement quality reviewer's eligibility, the engagement quality reviewer should notify the appropriate individuals in the firm and (Ref: par. A23)
 - a. if the engagement quality review has not commenced, decline the appointment to perform the engagement quality review, or
 - b. if the engagement quality review has commenced, discontinue the performance of the engagement quality review.

Performance of the Engagement Quality Review

24. The firm should establish policies or procedures regarding the performance of the engagement quality review that address the following:
 - a. The engagement quality reviewer's responsibilities to perform procedures in accordance with paragraphs 25–26 at appropriate points in time during the engagement to provide an appropriate basis for an objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon
 - b. The responsibilities of the engagement partner in relation to the engagement quality review, including that the engagement partner is precluded from dating the engagement report until notification has been received from the engagement quality reviewer in accordance with paragraph 27 that the engagement quality review is complete (Ref: par. A24–A25)
 - c. Circumstances when the nature and extent of engagement team discussions with the engagement quality reviewer about a significant judgment give rise to a threat to the objectivity of the engagement quality reviewer and appropriate actions to take in these circumstances (Ref: par. A26)
25. In performing the engagement quality review, the engagement quality reviewer should do the following: (Ref: par. A27–A32)

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- a.* Read, and obtain an understanding about, information communicated by (Ref: par. A33)
 - i.* the engagement team regarding the nature and circumstances of the engagement and the entity, and
 - ii.* the firm related to the firm's monitoring and remediation process, in particular, identified deficiencies that may relate to, or affect, the areas involving significant judgments made by the engagement team
- b.* Discuss with the engagement partner and, if applicable, other members of the engagement team, significant matters and significant judgments made in planning, performing, and reporting on the engagement (Ref: par. A34–A37)
- c.* Based on the information obtained in (*a*) and (*b*), review selected engagement documentation relating to the significant judgments made by the engagement team and evaluate the following: (Ref: par. A38–A42)
 - i.* The basis for making those significant judgments, including, when applicable to the type of engagement, the exercise of professional skepticism by the engagement team
 - ii.* Whether the engagement documentation supports the conclusions reached
 - iii.* Whether the conclusions reached are appropriate
- d.* Evaluate the basis for the engagement partner's determination that relevant ethical requirements relating to independence, when applicable, have been fulfilled (Ref: par. A43)
- e.* Evaluate whether appropriate consultation has taken place on difficult or contentious matters or matters involving differences of opinion and the conclusions arising from those consultations (Ref: par. A44)
- f.* For audits of financial statements, evaluate the basis for the engagement partner's determination that the engagement partner's involvement has been sufficient and appropriate throughout the audit engagement such that the engagement partner has the basis for determining that the significant judgments made and the conclusions reached are appropriate given the nature and circumstances of the engagement. (Ref: par. A45–A46)

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- g. Review
 - i. for audits of financial statements, the financial statements and the auditor's report thereon, including, if applicable, the description of the key audit matters; (Ref: par. A47)
 - ii. for reviews of financial statements or financial information, the financial statements or financial information and the engagement report thereon; or (Ref: par. A47)
 - iii. for other engagements, the engagement report, and when applicable, the subject matter information. (Ref: par. A48)
26. The engagement quality reviewer should notify the engagement partner if the engagement quality reviewer has concerns that the significant judgments made by the engagement team, including the appropriate exercise of professional skepticism by the engagement team when applicable, or the conclusions reached thereon, are not appropriate. If such concerns are not resolved to the engagement quality reviewer's satisfaction, the engagement quality reviewer should notify appropriate individuals in the firm that the engagement quality review cannot be completed. (Ref: par. A49)

Completion of the Engagement Quality Review

27. The engagement quality reviewer should determine whether the requirements in this proposed SQMS with respect to the performance of the engagement quality review have been fulfilled and whether the engagement quality review is complete. If so, the engagement quality reviewer should notify the engagement partner that the engagement quality review is complete.

Documentation

28. The firm should establish policies or procedures that require the engagement quality reviewer to take responsibility for documentation of the engagement quality review. (Ref: par. A50)
29. The firm should establish policies or procedures that require documentation of the engagement quality review in accordance with paragraph 30 and that such documentation be included with the engagement documentation.
30. The engagement quality reviewer should determine that the documentation of the engagement quality review is sufficient to enable an experienced practitioner, having no previous connection with the engagement, to understand the nature, timing, and extent of the procedures performed by the engagement quality reviewer and, when applicable, individuals who assisted the reviewer, and the conclusions reached in performing the review. The engagement quality reviewer also should determine that the documentation of the engagement quality review includes the following: (Ref: par. A51–A53)
- a. The names of the engagement quality reviewer and individuals who assisted with the engagement quality review
 - b. An identification of the engagement documentation reviewed

- c. The basis for the engagement quality reviewer's determination in accordance with paragraph 27
- d. The notifications required in accordance with paragraphs 26 and 27
- e. The date of completion of the engagement quality review

Application and Other Explanatory Material

Appointment and Eligibility of Engagement Quality Reviewers

Assignment of Responsibility for the Appointment of Engagement Quality Reviewers (Ref: par. 17)

- A1.** Competence and capabilities that are relevant to an individual's ability to fulfill responsibility for the appointment of the engagement quality reviewer may include appropriate knowledge about the following:
- The responsibilities of an engagement quality reviewer
 - The criteria in paragraphs 18-19 regarding the eligibility of engagement quality reviewers
 - The nature and circumstances of the engagement or the entity subject to an engagement quality review, including the composition of the engagement team
- A2.** The firm's policies or procedures may specify that the individual responsible for the appointment of engagement quality reviewers not be a member of the engagement team for which an engagement quality review is to be performed. However, in certain circumstances (for example, in the case of a smaller firm or a sole practitioner), it may not be practicable for an individual other than a member of the engagement team to appoint the engagement quality reviewer.
- A3.** The firm may assign more than one individual to be responsible for appointing engagement quality reviewers. For example, the firm's policies or procedures may specify a different process for appointing engagement quality reviewers for audits of financial statements than for attestation examination engagements or other engagements, with different individuals responsible for each process.

Eligibility of the Engagement Quality Reviewer (Ref: par. 18)

- A4.** In some circumstances, for example, in the case of a smaller firm or a sole practitioner, there may not be a partner or other individual in the firm who is eligible to perform the engagement quality review. In these circumstances, the firm may contract with, or obtain the services of, individuals external to the firm to perform the engagement quality review. An individual external to the firm may be a partner or an employee of a network firm, a structure or organization within the firm's network, or a service provider. When using such an individual, the provisions in proposed SQMS *A Firm's System of Quality Management* addressing network requirements or network services or service providers apply.

Eligibility Criteria for the Engagement Quality Reviewer

Competence and Capabilities, Including Sufficient Time (Ref: par. 18a)

- A5.** Proposed SQMS *A Firm's System of Quality Management* describes characteristics related to competence, including the integration and application of technical competence, professional skills, and professional ethics, values, and attitudes.⁸ Matters that the firm may consider in determining that an individual has the necessary competence to perform an engagement quality review include, for example, the following:
- An understanding of professional standards and applicable legal and regulatory requirements and the firm's policies or procedures relevant to the engagement
 - Knowledge of the entity's industry
 - An understanding of, and experience relevant to, engagements of a similar nature and complexity
 - An understanding of the responsibilities of the engagement quality reviewer in performing and documenting the engagement quality review, which may be attained or enhanced by receiving relevant training from the firm
- A6.** The conditions, events, circumstances, actions, or inactions considered by the firm in determining that an engagement quality review is an appropriate response to address one or more quality risks⁹ may be an important consideration in the firm's determination of the competence and capabilities required to perform the engagement quality review for that engagement. Other considerations that the firm may take into account in determining whether the engagement quality reviewer has the competence and capabilities, including sufficient time, needed to evaluate the significant judgments made by the engagement team and the conclusions reached thereon include, for example, the following:
- The nature of the entity.
 - The specialization and complexity of the industry or regulatory environment in which the entity operates.
 - The extent to which the engagement relates to matters requiring specialized expertise (for example, with respect to IT or specialized areas of accounting or auditing), or scientific and engineering expertise, which may be needed for certain assurance engagements. Also see paragraph A19.
- A7.** In evaluating the competence and capabilities of an individual who may be appointed as an engagement quality reviewer, the findings arising from the firm's monitoring activities (for example, findings from the inspection of engagements for which the individual was an engagement team member or engagement quality reviewer) or the results of external inspections may also be relevant considerations.

⁸ Paragraph A89 of proposed SQMS *A Firm's System of Quality Management*.

⁹ See footnote 8.

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- A8.** A lack of appropriate competence or capabilities affects the ability of the engagement quality reviewer to exercise appropriate professional judgment in performing the review. For example, an engagement quality reviewer who lacks relevant industry experience may not possess the ability or confidence necessary to evaluate and, when appropriate, challenge significant judgments made and the exercise of professional skepticism, by the engagement team on a complex, industry-specific accounting or auditing matter.

Appropriate Authority (Ref: par. 18a)

- A9.** Actions at the firm level help to establish the authority of the engagement quality reviewer. For example, by creating a culture of respect for the role of the engagement quality reviewer, the engagement quality reviewer is less likely to experience pressure from the engagement partner or other personnel to inappropriately influence the outcome of the engagement quality review. In some cases, the engagement quality reviewer's authority may be enhanced by the firm's policies or procedures to address differences of opinion, which may include actions the engagement quality reviewer may take when a disagreement occurs between the engagement quality reviewer and the engagement team.
- A10.** The authority of the engagement quality reviewer may be diminished when
- the culture within the firm promotes respect for authority only for personnel at a higher level of hierarchy within the firm.
 - the engagement quality reviewer has a reporting line to the engagement partner, for example, when the engagement partner holds a leadership position in the firm or is responsible for determining the compensation of the engagement quality reviewer.

Relevant Ethical Requirements (Ref: par. 13c and 18b)

- A11.** The relevant ethical requirements that are applicable when undertaking an engagement quality review may vary, depending on the nature and circumstances of the engagement or the entity. Relevant ethical requirements may include various provisions, such as specific independence requirements, that apply to individuals, such as an engagement quality reviewer, and not the firm. For example, if a firm uses an external provider to perform an engagement quality review, that individual may be subject to independence requirements, but the entire firm for whom the individual works may not need to comply with independence requirements related to the entity.
- A12.** Relevant ethical requirements may also include provisions that address threats to independence created by long association with an audit or assurance client. The application of any such provisions dealing with long association is distinct from, but may need to be taken into consideration in applying, the required cooling-off period in accordance with paragraph 19.

Threats to the Objectivity of the Engagement Quality Reviewer

- A13.** Threats to the engagement quality reviewer's objectivity may be created by a broad range of facts and circumstances. Examples follow:
- A self-review threat may be created when the engagement quality reviewer previously was involved with significant judgments made by the engagement team, in particular, as the engagement partner or other engagement team member.

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- A familiarity or self-interest threat may arise when the engagement quality reviewer is a close or immediate family member of the engagement partner or another member of the engagement team, or through close personal relationships with members of the engagement team.
- An intimidation threat may be created when actual or perceived pressure is exerted on the engagement quality reviewer (for example, when the engagement partner is an aggressive or dominant individual, or the engagement quality reviewer has a reporting line to the engagement partner).

A14. Relevant ethical requirements may include requirements and guidance to identify, evaluate, and address threats to objectivity.

Law or Regulation Relevant to the Eligibility of the Engagement Quality Reviewer (Ref: par 18c)

A15. Law or regulation may prescribe additional requirements regarding the eligibility of the engagement quality reviewer. For example, the audit requirements of the FDIC regulations for certain financial institutions require the auditor (which includes the engagement quality reviewer) to be in compliance with the AICPA's Code of Professional Conduct and also meet the independence requirements and interpretations of the SEC and its staff.

Cooling-Off Period for an Individual After Previously Serving as the Engagement Partner (Ref: par. 19)

A16. In recurring engagements, the matters on which significant judgments are made often do not vary. Therefore, significant judgments made in prior periods may continue to affect judgments of the engagement team in subsequent periods. Therefore, the ability of an engagement quality reviewer to perform an objective evaluation of significant judgments is affected when the individual was previously involved with those judgments as the engagement partner. In such circumstances, it is important that appropriate safeguards are put in place to reduce threats to objectivity, in particular, the self-review threat, to an acceptable level. Accordingly, this proposed SQMS requires the firm to establish policies or procedures that specify a cooling-off period during which the engagement partner is precluded from being appointed as the engagement quality reviewer.

A17. The firm's policies or procedures also may address whether a cooling-off period is appropriate for an individual other than the engagement partner before becoming eligible to be appointed as the engagement quality reviewer on that engagement. In this regard, the firm may consider the nature of that individual's role and previous involvement with the significant judgments made on the engagement. For example, the firm may determine that an engagement partner responsible for the performance of audit procedures on the financial information of a component in a group audit engagement may not be eligible to be appointed as the group engagement quality reviewer because of that audit partner's involvement in the significant judgments affecting the group audit engagement.

Circumstances in Which the Engagement Quality Reviewer Uses Assistants (Ref: par. 20–21)

A18. In certain circumstances, it may be appropriate for the engagement quality reviewer to be assisted by an individual or team of individuals with the relevant expertise. For example, highly specialized knowledge, skills, or expertise may be useful for understanding certain transactions

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undertaken by the entity to help the engagement quality reviewer evaluate the significant judgments made by the engagement team related to those transactions.

- A19.** The guidance in paragraph A14 may be helpful to the firm when establishing policies or procedures that address threats to objectivity of individuals who assist the engagement quality reviewer.
- A20.** When the engagement quality reviewer is assisted by an individual external to the firm, the assistant's responsibilities, including those related to compliance with relevant ethical requirements, may be set out in the contract or other agreement between the firm and the assistant.
- A21.** The firm's policies or procedures may include responsibilities of the engagement quality reviewer to
- consider whether assistants understand their instructions and whether the work is being carried out in accordance with the planned approach to the engagement quality review, and
 - address matters raised by assistants, considering their significance and modifying the planned approach appropriately.

Impairment of the Engagement Quality Reviewer's Eligibility to Perform the Engagement Quality Review (Ref: par. 22–23)

- A22.** Factors that may be relevant to the firm in considering whether the eligibility of the engagement quality reviewer to perform the engagement quality review is impaired include the following:
- Whether changes in the circumstances of the engagement result in the engagement quality reviewer no longer having the appropriate competence and capabilities to perform the review
 - Whether changes in the other responsibilities of the engagement quality reviewer indicate that the individual no longer has sufficient time to perform the review
 - Notification from the engagement quality reviewer in accordance with paragraph 23
- A23.** In circumstances in which the engagement quality reviewer's eligibility to perform the engagement quality review becomes impaired, the firm's policies or procedures may set out a process by which alternative eligible individuals are identified. The firm's policies or procedures may also address the responsibility of the individual appointed to replace the engagement quality reviewer to perform procedures sufficient to fulfill the requirements of this proposed SQMS with respect to the performance of the engagement quality review. Such policies or procedures may further address the need for consultation in such circumstances and may include, for example, the following:
- Evaluation of whether any review work that has been performed by the engagement quality reviewer could be relied upon by the newly assigned engagement quality reviewer or whether all work would need to be reperformed
 - Consideration of the effect of an engagement quality review assistant on the transition, when such assistant has been involved in the engagement quality review prior to transition

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- Procedures undertaken by the engagement team to inform the newly assigned engagement quality reviewer about planning meeting discussions that have already occurred and other matters in which the previous engagement quality reviewer had been involved
- Documentation of the circumstances necessitating the change

Performance of the Engagement Quality Review (Ref: par. 24–27)

Engagement Partner Responsibilities in Relation to the Engagement Quality Review (Ref: par. 24b)

- A24.** Proposed Statement on Auditing Standards (SAS) *Quality Management for an Engagement Performed in Accordance With Generally Accepted Auditing Standards*¹⁰ establishes the requirements for the engagement partner in audit engagements for which an engagement quality review is required, including
- determining that an engagement quality reviewer has been appointed;
 - cooperating with the engagement quality reviewer and informing other members of the engagement team of their responsibility to do so;
 - discussing significant matters and significant judgments arising during the audit engagement, including those identified during the engagement quality review, with the engagement quality reviewer; and
 - not dating the auditor’s report until the completion of the engagement quality review.
- A25.** AU-C section 105, *Concepts Common to All Attestation Engagements*,^{11,*} also establishes requirements for the engagement partner in relation to the engagement quality review.

Discussions Between the Engagement Quality Reviewer and the Engagement Team (Ref: par. 24c)

- A26.** Frequent communication between the engagement team and engagement quality reviewer throughout the engagement may assist in facilitating an effective and timely engagement quality review. However, a threat to the objectivity of the engagement quality reviewer may be created depending on the timing and extent of the discussions with the engagement team about a significant judgment. The firm’s policies or procedures may set out the actions to be taken by the engagement quality reviewer or the engagement team to avoid situations in which the engagement quality reviewer is, or may be perceived to be, making decisions on behalf of the engagement team. For example, in these circumstances, the firm may require consultation about such significant judgments with other relevant personnel in accordance with the firm’s consultation policies or procedures.

¹⁰ Paragraph 36 of proposed Statement on Auditing Standards (SAS) *Quality Management for an Engagement Performed in Accordance With Generally Accepted Auditing Standards*.

¹¹ Paragraph 36 of International Standard on Assurance Engagements (ISAE) 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*.

* All AU-C sections can be found in AICPA *Professional Standards*.

Procedures Performed by the Engagement Quality Reviewer (Ref: par. 25–27)

- A27.** The firm’s policies or procedures may specify the nature, timing, and extent of the procedures performed by the engagement quality reviewer and also may emphasize the importance of the engagement quality reviewer exercising professional judgment in performing the review.
- A28.** The timing of the procedures performed by the engagement quality reviewer may depend on the nature and circumstances of the engagement or the entity, including the nature of the matters subject to the review. Timely review of the engagement documentation by the engagement quality reviewer throughout all stages of the engagement (for example, planning, performing, and reporting) allows matters to be promptly resolved to the engagement quality reviewer’s satisfaction on or before the date of the engagement report. For example, the engagement quality reviewer may perform procedures in relation to the overall strategy and plan for the engagement at the completion of the planning phase. Timely performance of the engagement quality review also may reinforce the exercise of professional judgment and, when applicable to the type of engagement, professional skepticism, by the engagement team in planning and performing the engagement.
- A29.** The nature and extent of the engagement quality reviewer’s procedures for a specific engagement may depend on the following, among other factors:
- The reasons for the assessments given to quality risks,¹² for example, engagements performed for entities in emerging industries or with complex transactions.
 - Identified deficiencies, and the remedial actions to address the identified deficiencies, related to the firm’s monitoring and remediation process, and any related guidance issued by the firm, which may indicate areas where more extensive procedures need to be performed by the engagement quality reviewer.
 - The complexity of the engagement.
 - The nature and size of the entity, including whether the entity is a listed entity.
 - Findings relevant to the engagement, such as the results of inspections undertaken by an external oversight authority in a prior period, or other concerns raised about the quality of the work of the engagement team.
 - Information obtained from the firm’s acceptance and continuance of client relationships and specific engagements.
 - For assurance engagements, the engagement team’s identification and assessment of, and responses to, risks of material misstatement in the engagement.
 - Whether members of the engagement team have cooperated with the engagement quality reviewer. The firm’s policies or procedures may address the actions the engagement quality reviewer takes in circumstances when the engagement team has not cooperated with the engagement quality reviewer, for example, informing an appropriate individual in the firm so appropriate action can be taken to resolve the issue.

¹² Paragraph A49 of proposed SQMS *A Firm’s System of Quality Management*.

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- A30.** The nature, timing, and extent of the engagement quality reviewer's procedures may need to change based on circumstances encountered in performing the engagement quality review.

Group Audit Considerations

- A31.** The performance of an engagement quality review for an audit of group financial statements may involve additional considerations for the individual appointed as the engagement quality reviewer for the group audit, depending on the size and complexity of the group. Paragraph 21a requires the firm's policies or procedures to require the engagement quality reviewer to take overall responsibility for the performance of the engagement quality review. In doing so, for larger and more complex group audits, the group engagement quality reviewer may need to discuss significant matters and significant judgments with key members of the engagement team other than the group engagement team (for example, those responsible for performing audit procedures on the financial information of a component). In these circumstances, the engagement quality reviewer may be assisted by individuals in accordance with paragraph 20. The guidance in paragraph A22 may be helpful when the engagement quality reviewer for the group audit is using assistants.
- A32.** In some cases, an engagement quality reviewer may be appointed for an audit of an entity or business unit that is part of a group, for example, when such an audit is required by law, regulation, or other reasons. In these circumstances, communication between the engagement quality reviewer for the group audit and the engagement quality reviewer for the audit of that entity or business unit may help the group engagement quality reviewer in fulfilling the responsibilities in accordance with paragraph 21a. For example, this may be the case when the entity or business unit has been identified as a component for purposes of the group audit and significant judgments related to the group audit have been made at the component level.

Information Communicated by the Engagement Team and the Firm (Ref: par. 25a)

- A33.** Obtaining an understanding of information communicated by the engagement team and the firm in accordance with paragraph 25a may assist the engagement quality reviewer in understanding the significant judgments that may be expected for the engagement. Such an understanding may also provide the engagement quality reviewer with a basis for discussions with the engagement team about the significant matters and significant judgments made in planning, performing, and reporting on the engagement. For example, a deficiency identified by the firm may relate to significant judgments made by other engagement teams for certain accounting estimates for a particular industry. When this is the case, such information may be relevant to the significant judgments made on the engagement with respect to those accounting estimates and, therefore, may provide the engagement quality reviewer with a basis for discussions with the engagement team in accordance with paragraph 25b.

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Significant Matters and Significant Judgments (Ref: par. 25b–c)

- A34.** For audits of financial statements, proposed SAS *Quality Management for an Engagement Performed in Accordance With Generally Accepted Auditing Standards*¹³ requires the engagement partner to review audit documentation relating to significant matters¹⁴ and significant judgments, including those relating to difficult or contentious matters identified during the engagement, and the conclusions reached.
- A35.** For audits of financial statements, proposed SAS *Quality Management for an Engagement Performed in Accordance With Generally Accepted Auditing Standards*¹⁵ provides examples of significant judgments that may be identified by the engagement partner related to the overall audit strategy and audit plan for undertaking the engagement, the execution of the engagement, and the overall conclusions reached by the engagement team.
- A36.** For engagements other than audits of financial statements, the significant judgments made by the engagement team may depend on the nature and circumstances of the engagement or the entity. For example, in an attestation engagement performed in accordance with *Statements on Standards for Attestation Engagements*, the engagement team’s determination of whether the criteria to be applied in the preparation of the subject matter information are suitable for the engagement may involve or require significant judgment.
- A37.** In performing the engagement quality review, the engagement quality reviewer may become aware of other areas where significant judgments would have been expected to be made by the engagement team for which further information may be needed about the engagement team’s procedures performed or the basis for conclusions reached. In those circumstances, discussions with the engagement quality reviewer may result in the engagement team concluding that additional procedures need to be performed.
- A38.** The information obtained in accordance with paragraphs 25a–b, and the review of selected documentation, assists the engagement quality reviewer in evaluating the engagement team’s basis for making the significant judgments. Other considerations that may be relevant to the engagement quality reviewer’s evaluation include, for example, the following:
- Remaining alert to changes in the nature and circumstances of the engagement or the entity that may result in changes in the significant judgments made by the engagement team
 - Applying an unbiased view in evaluating responses from the engagement team
 - Following up on inconsistencies identified in reviewing engagement documentation or inconsistent responses by the engagement team to questions relating to the significant judgments made
- A39.** The firm’s policies or procedures may specify engagement documentation to be reviewed by the engagement quality reviewer. In addition, such policies or procedures may indicate

¹³ Paragraph 31 of proposed SAS *Quality Management for An Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

¹⁴ Paragraph 8c of AU-C section 230, *Audit Documentation*.

¹⁵ Paragraph A92 of proposed SAS *Quality Management for An Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

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that the engagement quality reviewer exercises professional judgment in selecting additional engagement documentation to be reviewed relating to significant judgments made by the engagement team.

- A40.** Discussions about significant judgments with the engagement partner and, if applicable, other members of the engagement team, together with the engagement team's documentation, may assist the engagement quality reviewer in evaluating the exercise of professional skepticism, when applicable to the engagement, by the engagement team in relation to those significant judgments.
- A41.** For audits of financial statements, proposed SAS *Quality Management for an Engagement Performed in Accordance With Generally Accepted Auditing Standards*¹⁶ provides examples of the impediments to the exercise of professional skepticism at the engagement level, unconscious auditor biases that may impede the exercise of professional skepticism, and possible actions that the engagement team may take to mitigate impediments to the exercise of professional skepticism at the engagement level.
- A42.** For audits of financial statements, the requirements and relevant application material in proposed SAS *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*;¹⁷ AU-C section 540, *Auditing Accounting Estimates and Related Disclosures*;¹⁸ and other AU-C sections also provide examples of areas in an audit where the auditor exercises professional skepticism or examples of where appropriate documentation may help provide evidence about how the auditor exercised professional skepticism. Such guidance may also assist the engagement quality reviewer in evaluating the exercise of professional skepticism by the engagement team.

Whether Relevant Ethical Requirements Relating to Independence Have Been Fulfilled (Ref: par. 25d)

- A43.** Proposed SAS *Quality Management for an Engagement Performed in Accordance With Generally Accepted Auditing Standards*¹⁹ requires the engagement partner, prior to dating the auditor's report, to take responsibility for determining whether relevant ethical requirements, including those related to independence, have been fulfilled.

Whether Consultation Has Taken Place on Difficult or Contentious Matters or Matters Involving Differences of Opinion (Ref: par. 25e)

- A44.** Proposed SQMS *A Firm's System of Quality Management*²⁰ addresses consultation on difficult or contentious matters and differences of opinion within the engagement team, or

¹⁶ Paragraphs A33–A35 of proposed SAS *Quality Management for An Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

¹⁷ Paragraph A255 of proposed SAS *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

¹⁸ Paragraph .A11 of AU-C section 540, *Auditing Accounting Estimates and Related Disclosures*.

¹⁹ Paragraph 21 of proposed SAS *Quality Management for An Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

²⁰ Paragraphs 32d–e and A80–A83 of proposed SQMS *A Firm's System of Quality Management*.

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between the engagement team and the engagement quality reviewer or individuals performing activities within the firm's system of quality management.

Sufficient and Appropriate Involvement of the Engagement Partner on the Engagement (Ref: par. 25f)

- A45.** Proposed SAS *Quality Management for an Engagement Performed in Accordance With Generally Accepted Auditing Standards*²¹ requires the engagement partner to determine, prior to dating the auditor's report, that the engagement partner's involvement has been sufficient and appropriate throughout the audit engagement such that the engagement partner has the basis for determining that the significant judgments made and the conclusions reached are appropriate given the nature and circumstances of the engagement. Proposed SAS *Quality Management for an Engagement Performed in Accordance With Generally Accepted Auditing Standards*¹²² also indicates that the documentation of the involvement of the engagement partner may be accomplished in different ways. Discussions with the engagement team, and review of such engagement documentation, may assist the engagement quality reviewer's evaluation of the basis for the engagement partner's determination that the engagement partner's involvement has been sufficient and appropriate.
- A46.** Proposed SAS *Quality Management for an Engagement Performed in Accordance With Generally Accepted Auditing Standards* is adapted, as necessary, to engagements performed in accordance with generally accepted auditing standards other than audits of financial statements. Accordingly, the requirement in paragraph 25f may also be applied, as necessary, to those engagements.

Review of Financial Statements and Engagement Reports (Ref: par. 25g)

- A47.** For audits of financial statements, the engagement quality reviewer's review of the financial statements and auditor's report thereon is consistent with the engagement quality reviewer's understanding of those matters based on the review of selected engagement documentation and discussions with the engagement team. In reviewing the financial statements, the engagement quality reviewer may also become aware of other areas where significant judgments would have been expected to be made by the engagement team for which further information may be needed about the engagement team's procedures or conclusions. The guidance in this paragraph also applies to review engagements and the related engagement report.
- A48.** For engagements other than audits of financial statements, the engagement quality reviewer's review of the engagement report and, when applicable, the subject matter information may include considerations similar to those described in paragraph A46 (for example, whether the presentation or description of matters relating to the significant judgments made by the engagement team are consistent with the engagement quality

²¹ Paragraph 40a of proposed SAS *Quality Management for An Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

²² Paragraph A118 of proposed SAS *Quality Management for An Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

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reviewer's understanding based on the procedures performed in connection with the review).

Unresolved Concerns of the Engagement Quality Reviewer (Ref: par. 26)

A49. The firm's policies or procedures may specify the individuals in the firm to be notified if the engagement quality reviewer has unresolved concerns that the significant judgments made by the engagement team, or the conclusions reached thereon, are not appropriate. Such individuals may include the individual assigned the responsibility for the appointment of engagement quality reviewers. With respect to such unresolved concerns, the firm's policies or procedures may also require consultation within or outside the firm (for example, a professional or regulatory body).

Documentation (Ref: par. 28–30)

A50. Paragraphs 58–61 of proposed SQMS *A Firm's System of Quality Management* address the firm's documentation of its system of quality management, which includes the firm's policies and procedures addressing engagements that are required to be subject to engagement quality reviews. This proposed SQMS addresses additional documentation requirements related to such policies and procedures as well as documentation requirements related to the performance of engagement quality reviews undertaken at the engagement level.

A51. The form, content, and extent of the documentation of the engagement quality review may depend on the following factors:

- The nature and complexity of the engagement
- The nature of the entity
- The nature and complexity of the matters subject to the engagement quality review
- The extent of the engagement documentation reviewed

A52. The performance and notification of the completion of the engagement quality review may be documented in a number of ways. For example, the engagement quality reviewer may document the review of engagement documentation electronically in the IT application for the performance of the engagement. Alternatively, the engagement quality reviewer may document the review through means of a memorandum. The engagement quality reviewer's procedures may also be documented in other ways, for example, in the minutes of the engagement team's discussions when the engagement quality reviewer was present.

A53. Paragraph 24*b* requires that the firm's policies or procedures preclude the engagement partner from dating the engagement report until the completion of the engagement quality review, which includes resolving matters raised by the engagement quality reviewer. Provided that all requirements with respect to the performance of the engagement quality review have been fulfilled, the documentation of the review may be finalized after the date of the engagement report but before the assembly of the final engagement file.

Proposed Statement on Auditing Standards (SAS)
Quality Management for an Engagement Conducted in Accordance With
Generally Accepted Auditing Standards

Introduction

Scope of This Proposed Statement on Auditing Standards

1. This proposed Statement on Auditing Standards (SAS) addresses the specific responsibilities of the auditor regarding quality management at the engagement level for an audit of financial statements and the related responsibilities of the engagement partner. This proposed SAS also applies, adapted as necessary, to other engagements conducted in accordance with generally accepted auditing standards (GAAS) (for example, a review of interim financial information conducted in accordance with AU-C section 930, *Interim Financial Information*).* This proposed SAS is to be read in conjunction with the AICPA Code of Professional Conduct (AICPA code) and other relevant ethical requirements. (Ref: par. A1, A38)
2. Although Statements on Quality Management Standards (SQMSs) are not applicable to auditors in government audit organizations, this proposed SAS is applicable to auditors in government audit organizations who perform financial audits in accordance with GAAS.¹

The Firm's System of Quality Management and Role of Engagement Teams

3. Under proposed SQMS *A Firm's System of Quality Management* the objective of the firm is to design, implement, and operate a system of quality management for engagements performed by the firm in its accounting and auditing practice that provides the firm with reasonable assurance that (Ref: par. A2–A3)
 - a. the firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements and conduct engagements in accordance with such standards and requirements; and
 - b. engagement reports issued by the firm or engagement partners are appropriate in the circumstances.²
4. The engagement team, led by the engagement partner, is responsible, within the context of the firm's system of quality management and through complying with the requirements of this proposed SAS, for the following: (Ref: par. A4–A11)
 - a. Implementing the firm's responses to quality risks (that is, the firm's policies or procedures) that are applicable to the audit engagement using information communicated by, or obtained from, the firm
 - b. Given the nature and circumstances of the audit engagement, determining whether to design and implement responses at the engagement level beyond those in the firm's policies or procedures

* All AU-C sections can be found in AICPA *Professional Standards*.

¹ Paragraph 5 of proposed SQMS *A Firm's System of Quality Management*.

² Paragraph 15 of proposed SQMS *A Firm's System of Quality Management*.

- c. Communicating to the firm information from the audit engagement that is required to be communicated by the firm’s policies or procedures to support the design, implementation, and operation of the firm’s system of quality management.
5. Complying with the requirements in other AU-C sections may provide information that is relevant to quality management at the engagement level. (Ref: par. A12)
6. The public interest is served by the consistent performance of quality audit engagements through achieving the objective of this proposed SAS and other AU-C sections for each engagement. A quality audit engagement is achieved through planning and performing the engagement and reporting on it in accordance with professional standards and applicable legal and regulatory requirements. Achieving the objectives of those standards and complying with the requirements of applicable law or regulation involves exercising professional judgment and exercising professional skepticism.
7. In accordance with AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*,³ the engagement team is required to plan and perform an audit with professional skepticism and to exercise professional judgment. Professional judgment is exercised in making informed decisions about the courses of action that are appropriate to manage and achieve quality given the nature and circumstances of the audit engagement. Professional skepticism supports the quality of judgments made by the engagement team and, through these judgments, supports the overall effectiveness of the engagement team in achieving quality at the engagement level. The appropriate exercise of professional skepticism may be demonstrated through the actions and communications of the engagement team. Such actions and communications may include specific steps to mitigate impediments that may impair the appropriate exercise of professional skepticism, such as unconscious bias or resource constraints. (Ref: par. A33–A36)

Scalability

8. The requirements of this proposed SAS are intended to be applied in the context of the nature and circumstances of each audit. Examples follow:
 - When an audit is carried out entirely by the engagement partner, which may be the case for an audit of a less complex entity, some requirements in this proposed SAS are not relevant because they are conditional on the involvement of other members of the engagement team. (Ref: par. A13–A14)
 - When an audit is not carried out entirely by the engagement partner or in an audit of an entity whose nature and circumstances are more complex, the engagement partner may assign the design or performance of some procedures, tasks, or actions to other members of the engagement team.

The Engagement Partner’s Responsibilities

9. The engagement partner remains ultimately responsible and, therefore, accountable, for compliance with the requirements of this proposed SAS. The phrase “take responsibility for...” is

³ Paragraphs .17–.18 and .A22–.A31 of AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

used for those requirements for which the engagement partner is permitted to assign the design or performance of procedures, tasks, or actions to appropriately skilled or suitably experienced members of the engagement team. For other requirements, this proposed SAS expressly intends that the requirement or responsibility be fulfilled by the engagement partner, and the engagement partner may obtain information from the firm or other members of the engagement team. (Ref: par. A22–A25)

Effective Date

10. This proposed SAS is effective for engagements conducted in accordance with GAAS for periods beginning on or after [December 15, 2023].*

Objective

11. The objective of the auditor is to manage quality at the engagement level to obtain reasonable assurance that quality has been achieved such that

- a. the auditor has fulfilled the auditor’s responsibilities, and has conducted the audit, in accordance with professional standards and applicable legal and regulatory requirements; and
- b. the auditor’s report issued is appropriate in the circumstances.

Definitions

12. For purposes of GAAS, the following terms have the meanings attributed as follows:

Engagement partner.⁴ The partner or other individual appointed by the firm, who is responsible for the audit engagement and its performance, and for the auditor’s report that is issued on behalf of the firm, and who, when required, has the appropriate authority from a professional, legal, or regulatory body.

Engagement quality review. An objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon, performed by the engagement quality reviewer and completed on or before the date of the engagement report.

Engagement quality reviewer. A partner, other individual in the firm, or an external individual appointed by the firm to perform the engagement quality review.

Engagement team. All partners and staff performing the audit engagement, and any other individuals who perform audit procedures on the engagement, excluding an

* This date is provisional but will not be earlier than December 15, 2023.

⁴ *Engagement partner, partner, and firm* refer to their governmental equivalents when relevant.

auditor's external specialist⁵ and internal auditors who provide direct assistance on an engagement.⁶ (Ref: par. A15–A25)

Firm. A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the AICPA and is engaged in public practice. (Ref: par. A26)

Network. An association of entities, as defined in “Definitions” (ET section 0.400) in the AICPA Code of Professional Conduct. (Ref: par. A27)

Network firm. A firm or other entity that belongs to a network, as defined in “Definitions” (ET section 0.400) in the AICPA Code of Professional Conduct. References to a *network firm* are to be read hereafter as “another firm or entity that belongs to the same network as the firm.” (Ref: par. A27)

Partner. Any individual with authority to bind the firm with respect to the performance of a professional services engagement. For purposes of this definition, *partner* may include an employee with this authority who has not assumed the risks and benefits of ownership. Firms might use different titles to refer to individuals with this authority.

Personnel. Partners and staff in the firm.

Professional standards. Standards promulgated by the AICPA Auditing Standards Board or the AICPA Accounting and Review Services Committee under the “General Standards Rule” (ET sec. 1.300.001) or the “Compliance With Standards Rule” (ET sec. 1.310.001) of the AICPA Code of Professional Conduct, or other standard-setting bodies that set auditing and attest standards applicable to the engagement being performed and relevant ethical requirements.

Relevant ethical requirements. Principles of professional ethics and ethical requirements to which the engagement team and engagement quality reviewer are subject, which consist of the AICPA Code of Professional Conduct together with rules of applicable state boards of accountancy and applicable regulatory agencies that are more restrictive.

Response (in relation to a system of quality management). Policies or procedures designed and implemented by the firm to address one or more quality risks:

- Policies are statements of what should, or should not, be done to address a quality risk or risks. Such statements may be documented, explicitly stated in communications, or implied through actions and decisions.
- Procedures are actions to implement policies.

Staff. Professionals, other than partners, including any specialist the firm employs.

⁵ Paragraph .06 of AU-C section 620, *Using the Work of an Auditor's Specialist*, defines the term *auditor's specialist*.

⁶ AU-C section 610, *Using the Work of Internal Auditors*, establishes limits on the use of direct assistance.

Requirements

Leadership Responsibilities for Managing and Achieving Quality on Audits

13. The engagement partner should take overall responsibility for managing and achieving quality on the audit engagement, including taking responsibility for creating an environment for the engagement that emphasizes the firm's culture and expected behavior of engagement team members. In doing so, the engagement partner should be sufficiently and appropriately involved throughout the audit engagement such that the engagement partner has the basis for determining whether the significant judgments made, and the conclusions reached, are appropriate given the nature and circumstances of the engagement. (Ref: par. A28–A37)

14. In creating the environment described in paragraph 13, the engagement partner should take responsibility for clear, consistent, and effective actions being taken that reflect the firm's commitment to quality and that establish and communicate the expected behavior of engagement team members, including emphasizing the following: (Ref: par. A30–A34)

- a.* That all engagement team members are responsible for contributing to the management and achievement of quality at the engagement level
- b.* The importance of professional ethics, values, and attitudes to the members of the engagement team
- c.* The importance of open and robust communication within the engagement team and supporting the ability of engagement team members to raise concerns without fear of reprisal
- d.* The importance of each engagement team member exercising professional skepticism throughout the audit engagement

15. If the engagement partner assigns the design or performance of procedures, tasks, or actions related to a requirement of this proposed SAS to other members of the engagement team to assist the engagement partner in complying with the requirements of this proposed SAS, the engagement partner should continue to take overall responsibility for managing and achieving quality on the audit engagement through direction and supervision of those members of the engagement team and review of their work. (Ref: par. 9 and A37)

Relevant Ethical Requirements, Including Those Related to Independence

16. The engagement partner should have an understanding of the relevant ethical requirements, including those related to independence, that are applicable given the nature and circumstances of the audit engagement. (Ref: par. A38–A42 and A48)

17. The engagement partner should take responsibility for other members of the engagement team having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the audit engagement, and the firm's related policies or procedures, including those that address the following: (Ref: par. A23–A25 and A40–A44)

- a.* Identifying, evaluating, and addressing threats to compliance with relevant ethical requirements, including those related to independence

- b. Circumstances that may cause a breach of relevant ethical requirements, including those related to independence, and the responsibilities of members of the engagement team when they become aware of breaches
 - c. The responsibilities of members of the engagement team when they become aware of an instance of noncompliance with laws and regulations by the entity⁷
18. If matters come to the engagement partner's attention that indicate that a threat to compliance with relevant ethical requirements exists, the engagement partner should evaluate the threats by complying with the firm's policies or procedures; using relevant information from the firm, the engagement team, or other sources; and take appropriate action. (Ref: par. A43–A44)
19. The engagement partner should remain alert throughout the audit engagement, through observation and making inquiries as necessary, for breaches of relevant ethical requirements or the firm's related policies or procedures by members of the engagement team. (Ref: par. A45)
20. If matters come to the engagement partner's attention through the firm's system of quality management, or from other sources, that indicate that relevant ethical requirements applicable to the nature and circumstances of the audit engagement have not been fulfilled, the engagement partner, in consultation with others in the firm, should take appropriate action. (Ref: par. A46)
21. Prior to dating the auditor's report, the engagement partner should take responsibility for determining whether relevant ethical requirements, including those related to independence, have been fulfilled. (Ref: par. A38 and A47)

Acceptance and Continuance of Client Relationships and Audit Engagements

22. The engagement partner should determine that the firm's policies or procedures for the acceptance and continuance of client relationships and audit engagements have been followed, and that conclusions reached in this regard are appropriate. (Ref: par. A49–A52, A58)
23. The engagement partner should take into account information obtained in the acceptance and continuance process in planning and performing the audit engagement in accordance with GAAS and complying with the requirements of this proposed SAS. (Ref: par. A53–A56)
24. If the engagement team becomes aware of information that may have caused the firm to decline the audit engagement had that information been known by the firm prior to accepting or continuing the client relationship or specific engagement, the engagement partner should communicate that information promptly to the firm, so that the firm and the engagement partner can take the necessary action. (Ref: par. A57)

Engagement Resources

25. The engagement partner should determine that sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team in a timely manner, taking into account the nature and circumstances of the audit engagement, the firm's policies or procedures, and any changes that may arise during the engagement. (Ref: par. A59–A70, A73–A74, and A79)

⁷ See AU-C section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*.

- 26.** The engagement partner should determine that members of the engagement team, and any auditor’s external specialists and internal auditors who provide direct assistance who are not part of the engagement team, collectively have the appropriate competence and capabilities, including sufficient time, to perform the audit engagement. (Ref: par. A62 and A71–A74)
- 27.** If, as a result of complying with the requirements in paragraphs 25 and 26, the engagement partner determines that resources assigned or made available are insufficient or inappropriate in the circumstances of the audit engagement, the engagement partner should take appropriate action, including communicating with appropriate individuals about the need to assign or make available additional or alternative resources to the engagement. (Ref: par. A75–A78)
- 28.** The engagement partner should take responsibility for using the resources assigned or made available to the engagement team appropriately, given the nature and circumstances of the audit engagement. (Ref: par. A63–A69)

Engagement Performance

Direction, Supervision, and Review

- 29.** The engagement partner should take responsibility for the direction and supervision of the members of the engagement team and the review of their work. (Ref: par. A80)
- 30.** The engagement partner should determine that the nature, timing, and extent of direction; supervision, and review is (Ref: par. A81–A89 and A94–A97)
- a. planned⁸ and performed in accordance with the firm’s policies or procedures, professional standards, and applicable legal and regulatory requirements, and
 - b. responsive to the nature and circumstances of the audit engagement and the resources assigned or made available to the engagement team by the firm.
- 31.** The engagement partner should review audit documentation at appropriate points in time during the audit engagement, including audit documentation relating to (Ref: par. A90–A93)
- a. significant matters;⁹
 - b. significant judgments, including those relating to difficult or contentious matters identified during the audit engagement, and the conclusions reached; and
 - c. other matters that, in the engagement partner’s professional judgment, are relevant to the engagement partner’s responsibilities.
- 32.** On or before the date of the auditor’s report, the engagement partner should determine, through review of audit documentation and discussion with the engagement team, that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor’s report to be issued. (Ref: par. A90–A94)
- 33.** Prior to dating the auditor’s report, the engagement partner should review the financial statements and the auditor’s report, including, if applicable, the description of the key audit

⁸ Paragraph .11 of AU-C section 300, *Planning an Audit of Financial Statements*.

⁹ Paragraph .08 of AU-C section 230, *Audit Documentation*.

matters¹⁰ and related audit documentation, to determine that the report to be issued will be appropriate in the circumstances.¹¹

34. The engagement partner should review, prior to their issuance, formal written communications to management, those charged with governance, or regulatory authorities. (Ref: par. A98)

Consultation

35. The engagement partner should (Ref: par. A99–A102)

- a. take responsibility for the engagement team undertaking consultation on
 - i. difficult or contentious matters and matters on which the firm’s policies or procedures require consultation, and
 - ii. other matters that, in the engagement partner’s professional judgment, require consultation;
- b. determine that members of the engagement team have undertaken appropriate consultation during the audit engagement, both within the engagement team, and between the engagement team and others at the appropriate level within or outside the firm,
- c. determine that the nature and scope of, and conclusions resulting from, such consultations are agreed with the party consulted, and
- d. determine that conclusions agreed have been implemented.

Engagement Quality Review

36. For audit engagements for which an engagement quality review is required, the engagement partner should (Ref: par. A103)

- a. determine that an engagement quality reviewer has been appointed,
- b. cooperate with the engagement quality reviewer and inform other members of the engagement team of their responsibility to do so,
- c. discuss significant matters and significant judgments arising during the audit engagement, including those identified during the engagement quality review, with the engagement quality reviewer, and
- d. not date the auditor’s report until the completion of the engagement quality review. (Ref: par. A104–A106)

¹⁰ See AU-C section 701, *Communicating Key Audit Matters in the Auditor’s Report*.

¹¹ See AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*, or AU-C section 705, *Modifications to the Opinion in the Independent Auditor’s Report*.

Differences of Opinion

37. If differences of opinion arise within the engagement team, or between the engagement team and the engagement quality reviewer or individuals performing activities within the firm's system of quality management, including those who provide consultation, the engagement team should follow the firm's policies or procedures for dealing with and resolving such differences of opinion. (Ref: par. A107–A108)

38. The engagement partner should

- a. take responsibility for differences of opinion being addressed and resolved in accordance with the firm's policies or procedures,
- b. determine that conclusions reached are documented and implemented, and
- c. not date the auditor's report until any differences of opinion are resolved.

Monitoring and Remediation

39. The engagement partner should take responsibility for the following: (Ref: par. A109–A112)

- a. Obtaining an understanding of the information from the firm's monitoring and remediation process, as communicated by the firm, including, as applicable, the information from the monitoring and remediation process of the network and across the network firms
- b. Determining the relevance and effect on the audit engagement of the information referred to in paragraph 39a and take appropriate action
- c. Remaining alert throughout the audit engagement for information that may be relevant to the firm's monitoring and remediation process and communicate such information to those responsible for the process

Taking Overall Responsibility for Managing and Achieving Quality

40. Prior to dating the auditor's report, the engagement partner should determine that the engagement partner has taken overall responsibility for managing and achieving quality on the audit engagement. In doing so, the engagement partner should determine that (Ref: par. A113–A116)

- the engagement partner's involvement has been sufficient and appropriate throughout the audit engagement such that the engagement partner has the basis for determining that the significant judgments made and the conclusions reached are appropriate given the nature and circumstances of the engagement; and
- the nature and circumstances of the audit engagement, any changes thereto, and the firm's related policies or procedures have been taken into account in complying with the requirements of this proposed SAS.

Documentation

41. In applying AU-C section 230, *Audit Documentation*, the auditor should include the following in the audit documentation:¹² (Ref: par. A117–A120)
- a. Significant issues identified, relevant discussions with personnel, and conclusions reached with respect to
 - i. fulfillment of responsibilities relating to relevant ethical requirements, including those related to independence
 - ii. the acceptance and continuance of the client relationship and audit engagement
 - b. The nature and scope of, and conclusions resulting from, consultations undertaken during the audit engagement and how such conclusions were implemented
 - c. If the audit engagement is subject to an engagement quality review, that the engagement quality review has been completed on or before the date of the auditor’s report

Application and Other Explanatory Material

Scope of This Proposed SAS (Ref: par. 1)

A1. This proposed SAS applies to all audits of financial statements, including audits of group financial statements. AU-C section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*, deals with special considerations that apply to an audit of group financial statements, including when component auditors are involved. AU-C section 600 also provides guidance on how to adapt and apply the requirements of this proposed SAS in an audit of group financial statements involving component auditors. AU-C section 600, adapted as necessary in the circumstances, may also be useful in an audit of financial statements when the engagement team includes individuals from another firm. For example, AU-C section 600 may be useful when involving such an individual to attend a physical inventory count; inspect property, plant, and equipment; or perform audit procedures at a shared service center at a remote location.

The Firm’s System of Quality Management and Role of Engagement Teams (Ref: par. 3–9)

- A2. Proposed SQMS *A Firm’s System of Quality Management* addresses a firm’s responsibilities for designing, implementing, and operating its system of quality management.
- A3. Firms may use different terminology or frameworks to describe the components of the system of quality management.

The Engagement Team’s Responsibilities Relating to the Firm’s System of Quality Management (Ref: par. 4)

A4. Quality management at the engagement level is supported by the firm’s system of quality management and informed by the specific nature and circumstances of the audit engagement. In accordance with proposed SQMS *A Firm’s System of Quality Management*, the firm is responsible for communicating information that enables the engagement team to understand and carry out their

¹² Paragraphs .08–.11 of AU-C section 230.

responsibilities relating to performing engagements. For example, such communications may cover policies or procedures to undertake consultations with designated individuals in certain situations involving complex technical or ethical matters or to involve firm-designated experts in specific engagements to perform audit procedures related to particular matters (for example, the firm may specify that firm-designated credit-risk modeling experts are to be involved in auditing expected credit loss allowances in audits of financial institutions).

A5. Firm-level responses may include policies or procedures established by a network or by other firms, structures, or organizations within the same network (network requirements or network services are described further in proposed SQMS A Firm's System of Quality Management within the "Network Requirements or Network Services" section).¹³ The requirements of this proposed SAS are based on the premise that the firm is responsible for taking the necessary action to enable engagement teams to implement or use network requirements or network services on the audit engagement (for example, a requirement to use an audit methodology developed for use by a network firm). Under proposed SQMS A Firm's System of Quality Management, the firm is responsible for determining how network requirements or network services are relevant to, and are taken into account in, the firm's system of quality management.¹⁴

A6. Some firm-level responses to quality risks are not performed at the engagement level but are, nevertheless, relevant when complying with the requirements of this proposed SAS. For example, firm-level responses that the engagement team may be able to depend on when complying with the requirements of this proposed SAS include

- personnel recruitment and professional training processes,
- the IT applications that support the firm's monitoring of independence,
- the development of IT applications that support the acceptance and continuance of client relationships and audit engagements, and
- the development of audit methodologies and related implementation tools and guidance.

A7. Due to the specific nature and circumstances of each audit engagement and changes that may occur during the audit engagement, a firm cannot identify all quality risks that may arise at the engagement level or set forth all relevant and appropriate responses. Accordingly, the engagement team exercises professional judgment in determining whether to design and implement responses, beyond those set forth in the firm's policies or procedures, at the engagement level to meet the objective of this proposed SAS.¹⁵

A8. The engagement team's determination of whether engagement-level responses are necessary (and, if so, what those responses are) is influenced by the requirements of this proposed SAS, the engagement team's understanding of the nature and circumstances of the engagement, and any changes during the audit engagement. For example, unanticipated circumstances may arise during the engagement that may cause the engagement partner to request the involvement of

¹³ Paragraph 50b of proposed SQMS A Firm's System of Quality Management.

¹⁴ Paragraph 50a of proposed SQMS A Firm's System of Quality Management.

¹⁵ AU-C section 200 requires the auditor to exercise professional judgment in planning and performing an audit of financial statements.

appropriately experienced personnel in addition to those initially assigned or made available by the firm.

A9. The relative balance of the engagement team's efforts to comply with the requirements of this proposed SAS (that is, between implementing the firm's responses and designing and implementing engagement-specific responses beyond those set forth in the firm's policies or procedures) may vary. For example, the firm may design an audit program to be used in circumstances that are applicable to the audit engagement (for example, an industry-specific audit program). Other than determining the timing and extent of procedures to be performed, there may be little or no need for supplemental audit procedures to be added to the audit program at the engagement level. Alternatively, the engagement team's actions in complying with the engagement performance requirements of this proposed SAS may be more focused on designing and implementing responses at the engagement level to deal with the specific nature and circumstances of the engagement (for example, planning and performing procedures to address risks of material misstatement not contemplated by the firm's audit programs).

A10. Ordinarily, the engagement team may depend on the firm's policies or procedures in complying with the requirements of this proposed SAS, unless

- the engagement team's understanding or practical experience indicates that the firm's policies or procedures will not effectively address the nature and circumstances of the engagement, or
- information provided by the firm or other parties, about the effectiveness of such policies or procedures suggests otherwise (for example, information provided by the firm's monitoring activities, external inspections, or other relevant sources indicates that the firm's policies or procedures are not operating effectively).

A11. If the engagement partner becomes aware (including by being informed by other members of the engagement team) that the firm's responses to quality risks are ineffective in the context of the specific engagement or the engagement partner is unable to depend on the firm's policies or procedures, the engagement partner communicates such information promptly to the firm in accordance with paragraph 39c because such information is relevant to the firm's monitoring and remediation process. For example, if an engagement team member identifies that an audit software program has a security weakness, timely communication of such information to the appropriate personnel enables the firm to take steps to update and reissue the audit program. See also paragraph A69 in respect of sufficient and appropriate resources.

Information Relevant to Quality Management at the Engagement Level (Ref: par. 5)

A12. Complying with the requirements in other AU-C sections may provide information that is relevant to quality management at the engagement level. For example, the understanding of the entity and its environment required to be obtained under AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, provides information that may be relevant to complying with the requirements of this proposed SAS. Such information may be relevant to the determination of one or more of the following:

- The nature of resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high risk areas or the involvement of experts to deal with complex matters

- The amount of resources to allocate to specific audit areas, such as the number of team members assigned to attend the physical inventory count at multiple locations
- The nature, timing, and extent of review of the work performed by members of the team based on the assessed risks of material misstatement
- The allocation of the budgeted audit hours, including allocating more time, and the time of more experienced engagement team members to those areas where there are more risks of material misstatement or the identified risks are assessed as higher

Scalability (Ref: par. 8)

A13. In a smaller firm, the firm's policies or procedures may designate an engagement partner or partners, on behalf of the firm, to design many of the responses to the firm's quality risks because doing so may be a more effective approach to designing and implementing responses as part of the firm's system of quality management. Additionally, a smaller firm's policies or procedures may be less formal. For example, in a very small firm with a relatively small number of audit engagements, the firm may determine that there is no need to establish a firm-wide system to monitor independence and, rather, independence will be monitored at the individual engagement level by the engagement partner.

A14. The requirements relating to direction, supervision, and review of the work of other members of the engagement team are only relevant if there are members of the engagement team other than the engagement partner.

Definitions

Engagement Team (Ref: par. 12d)

A15. The engagement team may be organized in a variety of ways. For example, engagement team members may be located together or across different geographic locations and may be organized in groups by the activity they are performing. Regardless of how the engagement team is organized, any individual who performs audit procedures¹⁶ on the audit engagement, excluding an auditor's external specialist¹⁷ and internal auditors who provide direct assistance on an engagement,¹⁸ is a member of the engagement team.

A16. The definition of an *engagement team* focuses on individuals who perform audit procedures on the audit engagement. *Audit evidence*, which is necessary to support the auditor's opinion and report, is primarily obtained from audit procedures performed during the course of the audit.¹⁹ Audit procedures comprise risk assessment procedures²⁰ and further audit

¹⁶ Paragraph .A44 of AU-C section 500, *Audit Evidence*.

¹⁷ Paragraph .06 of AU-C section 620 defines the term *auditor's specialist*.

¹⁸ AU-C section 610 establishes limits on the use of direct assistance.

¹⁹ Paragraph .A32 of AU-C section 200.

²⁰ AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, provides requirements related to risk assessment procedures.

procedures.²¹ As explained in AU-C section 500, *Audit Evidence*, audit procedures include inspection, observation, confirmation, recalculation, reperformance, analytical procedures, and inquiry, often performed in some combination.²² Other AU-C sections may also include specific procedures to obtain audit evidence, for example, AU-C section 520, *Analytical Procedures*.

A17. Engagement teams include personnel and may also include other individuals who perform audit procedures who are from

- a network firm, or
- a firm that is not a network firm or another service provider.²³

For example, an individual from another firm may perform audit procedures on the financial information of a component in a group audit engagement, attend a physical inventory count, or inspect physical fixed assets at a remote location.

A18. Engagement teams may also include individuals from service delivery centers who perform audit procedures. For example, it may be determined that specific tasks that are repetitive or specialized in nature will be performed by a group of appropriately skilled personnel; thus, the engagement team includes such individuals. Service delivery centers may be established by the firm, the network, or by other firms, structures, or organizations within the same network. For example, a centralized function may be used to facilitate external confirmation procedures.

A19. Engagement teams may include individuals with expertise in a specialized area of accounting or auditing who perform audit procedures on the audit engagement, for example, individuals with expertise in accounting for income taxes or in analyzing complex information produced by automated tools and techniques for the purpose of identifying unusual or unexpected relationships. An individual is not a member of the engagement team if that individual's involvement with the engagement is limited to consultation. Consultations are addressed in paragraphs 35 and A99–A102.

A20. If the audit engagement is subject to an engagement quality review, the engagement quality reviewer, and any other individuals performing the engagement quality review, are not members of the engagement team. Such individuals may be subject to specific independence requirements.

A21. An internal auditor providing direct assistance and an auditor's external specialist whose work is used in the engagement are not members of the engagement team.²⁴ AU-C sections 610, *Using the Work of Internal Auditors*, and 620, *Using the Work of an Auditor's Specialist*, provide requirements and guidance for the auditor when using the work of internal auditors in a direct assistance capacity or when using the work of an external specialist, respectively. Compliance with these AU-C sections requires the auditor to obtain sufficient appropriate audit evidence on

²¹ AU-C section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, provides requirements related to further audit procedures, including tests of controls and substantive procedures.

²² Paragraph .A43 of AU-C section 500.

²³ Paragraph 17v of proposed SQMS *A Firm's System of Quality Management*.

²⁴ See paragraphs .12–.13 of AU-C section 620 and paragraphs .20–.24 of AU-C section 610.

the work performed by an internal auditor who is providing direct assistance and perform audit procedures on the work of an auditor's specialist.

The Engagement Partner's Responsibilities (Ref: par. 9, 12d)

A22. When this proposed SAS expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the engagement partner may need to obtain information from the firm or other members of the engagement team to fulfill the requirement (for example, information to make the required decision or judgment). For example, the engagement partner is required to determine that members of the engagement team collectively have the appropriate competence and capabilities to perform the audit engagement. To make a judgment on whether the competence and capabilities of the engagement team is appropriate, the engagement partner may need to use information compiled by the engagement team or from the firm's system of quality management.

The Application of Firm Policies or Procedures by Members of the Engagement Team (Ref: par. 8)

A23. Within the context of the firm's system of quality management, engagement team members from the firm are responsible for implementing the firm's policies or procedures that are applicable to the audit engagement. Engagement team members from another firm are neither partners nor staff of the engagement partner's firm. As such, they may not be subject to the firm's system of quality management or the firm's policies or procedures. Further, the policies or procedures of another firm may not be similar to that of the engagement partner's firm. For example, policies or procedures regarding direction, supervision, and review may be different, particularly when the other firm is in a jurisdiction with a different legal system, language, or culture than that of the engagement partner's firm. Accordingly, when the engagement team includes individuals who are from another firm, different actions may need to be taken by the firm or the engagement partner to implement the firm's policies or procedures with respect to the work of those individuals.

A24. In particular, the firm's policies or procedures may require the firm or the engagement partner to take different actions from those applicable to personnel when obtaining an understanding of whether an individual from another firm

- has the appropriate competence and capabilities to perform the audit engagement. For example, the individual would not be subject to the firm's recruitment and training processes and, therefore, the firm's policies or procedures may state that this determination can be made through other actions such as obtaining information from the other firm or a licensing or oversight body. Paragraphs 22 and A47–A48 of AU-C section 600 contain guidance on obtaining an understanding of the competence and capabilities of component auditors.
- understands the ethical requirements that are relevant to the group audit engagement. For example, the individual would not be subject to the firm's training with regard to the firm's policies or procedures for relevant ethical requirements. The firm's policies or procedures may state that this understanding is obtained through other actions such as providing information, manuals, or guides containing the provisions of the relevant ethical requirements applicable to the audit engagement to the individual.

- will confirm independence. For example, individuals who are not personnel may not be able to complete independence declarations directly on the firm's independence systems. The firm's policies or procedures may state that such individuals can provide evidence of their independence in relation to the audit engagement in other ways, such as written confirmation.

A25. When firm policies or procedures require specific activities to be undertaken in certain circumstances (for example, consultation on a particular matter), it may be necessary to communicate with individuals who are not personnel about what is expected of them to enable the engagement partner to comply with the firm's policies or procedures. For example, in a group audit engagement, communicating the group auditor's policies and procedures about matters subject to consultation to a component auditor enables the component auditor to determine which identified difficult or contentious matters that are relevant to the group financial statements to bring to the attention of the group engagement team.

Firm (Ref: par. 12e)

A26. The definition of *firm* in relevant ethical requirements may differ from the definition set out in this proposed SAS.

“Network” and “Network Firm” (Ref: par. 12f–g)

A27. The definitions of *network* or *network firm* in relevant ethical requirements may differ from those set out in this proposed SAS. The AICPA code also provides guidance in relation to the terms *network* and *network firm*. Networks and other network firms may be structured in a variety of ways and are in all cases external to the firm. The provisions in this proposed SAS in relation to networks also apply to any structures or organizations that do not form part of the firm but that exist within the network.

Leadership Responsibilities for Managing and Achieving Quality in Audits (Ref: par. 13–15)

Taking Overall Responsibility for Managing and Achieving Quality

A28. Proposed SQMS *A Firm's System of Quality Management* requires the firm to establish quality objectives that address the firm's governance and leadership that supports the design, implementation, and operation of the system of quality management. The engagement partner's responsibility for managing and achieving quality is supported by a firm culture that demonstrates a commitment to quality. In addressing the requirements in paragraphs 13 and 14 of this proposed SAS, the engagement partner may communicate directly to other members of the engagement team and reinforce this communication through personal conduct and actions (for example, leading by example). A culture that demonstrates a commitment to quality is further shaped and reinforced by the engagement team members as they demonstrate expected behaviors when performing the engagement.

Scalability

A29. The nature and extent of the actions of the engagement partner to demonstrate the firm's commitment to quality may depend on a variety of factors, including the size, structure,

geographical dispersion, and complexity of the firm and the engagement team and the nature and circumstances of the audit engagement. With a smaller engagement team with few engagement team members, influencing the desired culture through direct interaction and conduct may be sufficient, whereas for a larger engagement team that is dispersed over many locations, more formal communications may be necessary.

Sufficient and Appropriate Involvement

A30. Being sufficiently and appropriately involved throughout the audit engagement may be demonstrated by the engagement partner in different ways, including the following:

- Taking responsibility for the nature, timing, and extent of the direction and supervision of the members of the engagement team and the review of their work in complying with the requirements of this proposed SAS
- Varying the nature, timing, and extent of such direction, supervision, and review in the context of the nature and circumstances of the engagement

Communication

A31. Communication is the means through which the engagement team shares relevant information on a timely basis to comply with the requirements of this proposed SAS, thereby contributing to the achievement of quality on the audit engagement. Communication may be between or among members of the engagement team or with

- a. the firm, (for example, individuals performing activities within the firm's system of quality management, including those assigned ultimate or operational responsibility for the firm's system of quality management),
- b. others involved in the audit (for example, internal auditors who provide direct assistance²⁵ or an auditor's external specialist²⁶), and
- c. parties that are external to the firm (for example, management, those charged with governance, or regulatory authorities).

A32. The nature and circumstances of the audit engagement may affect the engagement partner's decisions regarding the appropriate means of effective communication with the members of the engagement team. For example, to support appropriate direction, supervision, and review, the firm may use IT applications to facilitate the communication between the members of the engagement team when they are performing work across different geographical locations.

Professional Skepticism (Ref: par. 7)

A33. The engagement partner is responsible for emphasizing the importance of each engagement team member exercising professional skepticism throughout the audit engagement. Conditions inherent in some audit engagements can create pressures on the engagement team that may

²⁵ See paragraph .A47 of AU-C section 610.

²⁶ See paragraphs .11c and .A33 of AU-C section 620.

impede the appropriate exercise of professional skepticism when designing and performing audit procedures and evaluating audit evidence. Accordingly, when developing the overall audit strategy in accordance with AU-C section 300, *Planning an Audit*, the engagement team may need to consider whether such conditions exist in the audit engagement and, if so, what actions the firm or the engagement team may need to undertake to mitigate such impediments.

A34. Impediments to the exercise of professional skepticism at the engagement level may include the following:

- Budget constraints, which may discourage the use of sufficiently experienced or technically qualified resources, including experts, necessary for audits of entities in which technical expertise or specialized skills are needed for effective understanding, assessment of, and responses to risks and informed questioning of management.
- Tight deadlines, which may negatively affect the behavior of those who perform the work as well as those who direct, supervise, and review. For example, external time pressures may create restrictions to analyzing complex information effectively.
- Lack of cooperation or undue pressures imposed by management, which may negatively affect the engagement team's ability to resolve complex or contentious issues.
- Insufficient understanding of the entity and its environment, its system of internal control, and the applicable financial reporting framework, which may constrain the ability of the engagement team to make appropriate judgments and an informed questioning of management's assertions.
- Difficulties in obtaining access to records, facilities, certain employees, customers, vendors, or others, which may cause the engagement team to bias the selection of sources of audit evidence and seek audit evidence from sources that are more easily accessible.
- Overreliance on automated tools and techniques, which may result in the engagement team not critically assessing audit evidence.

A35. Unconscious or conscious auditor biases may affect the engagement team's professional judgments, including, for example, in the design and performance of audit procedures, or the evaluation of audit evidence. Examples of unconscious auditor biases that may impede the exercise of professional skepticism and, therefore, the reasonableness of the professional judgments made by the engagement team in complying with the requirements of this proposed SAS, may include the following:

- *Availability bias*, which is a tendency to place more weight on events or experiences that immediately come to mind or are readily available than on those that are not
- *Confirmation bias*, which is a tendency to place more weight on information that corroborates an existing belief than information that contradicts or casts doubt on that belief
- *Groupthink*, which is a tendency to think or make decisions as a group that discourages creativity or individual responsibility

- *Overconfidence bias*, which is a tendency to overestimate one's own ability to make accurate assessments of risk or other judgments or decisions
- *Anchoring bias*, which is a tendency to use an initial piece of information as an anchor against which subsequent information is inadequately assessed
- *Automation bias*, which is a tendency to favor output generated from automated systems, even when human reasoning or contradictory information raises questions about whether such output is reliable or fit for purpose.

A36. Possible actions that the engagement team may take to mitigate impediments to the exercise of professional skepticism at the engagement level may include the following:

- Remaining alert to changes in the nature or circumstances of the audit engagement that necessitate additional or different resources for the engagement and requesting additional or different resources from those individuals within the firm responsible for allocating or assigning resources to the engagement
- Explicitly alerting the engagement team to instances or situations in which vulnerability to unconscious or conscious auditor biases may be greater (for example, areas involving greater judgment) and emphasizing the importance of seeking advice from more experienced members of the engagement team in planning and performing audit procedures
- Changing the composition of the engagement team, for example, requesting that more experienced individuals with greater skills or knowledge or specific expertise are assigned to the engagement
- Involving more experienced members of the engagement team when dealing with members of management who are difficult or challenging to interact with
- Involving members of the engagement team with specialized skills and knowledge or an auditor's expert to assist the engagement team with complex or subjective areas of the audit
- Modifying the nature, timing, and extent of direction, supervision, or review by involving more experienced engagement team members, more in-person oversight on a more frequent basis, or more in-depth reviews of certain working papers for
 - complex or subjective areas of the audit;
 - areas that pose risks to achieving quality on the audit engagement;
 - areas with a fraud risk; and
 - identified or suspected noncompliance with laws or regulations
- Setting expectations for
 - less experienced members of the engagement team to seek advice frequently and in a timely manner from more experienced engagement team members or the engagement partner, and
 - more experienced members of the engagement team to be available to less experienced members of the engagement team throughout the audit engagement

and to respond positively and in a timely manner to their insights, requests for advice, or assistance

- Communicating with those charged with governance when management imposes undue pressure, or the engagement team experiences difficulties in obtaining access to records, facilities, certain employees, customers, vendors, or others from whom audit evidence may be sought

Assigning Procedures, Tasks, or Actions to Other Members of the Engagement Team (Ref: par. 15)

A37. Being sufficiently and appropriately involved throughout the audit engagement when procedures, tasks, or actions have been assigned to other members of the engagement team may be demonstrated by the engagement partner in different ways, including the following:

- Informing assignees about the nature of their responsibilities and authority, the scope of the work being assigned and the objectives thereof, and to provide any other necessary instructions and relevant information
- Direction and supervision of the assignees
- Review of the assignees' work to evaluate the conclusions reached, in addition to the requirements in paragraphs 29–34

Relevant Ethical Requirements, Including Those Related to Independence (Ref: par. 16–21)

Relevant Ethical Requirements (Ref: par. 1, 16–21)

A38. AU-C section 200²⁷ requires that the auditor comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements. Relevant ethical requirements may vary depending on the nature and circumstances of the engagement. For example, certain requirements related to independence may be applicable only when performing audits of listed entities. AU-C section 600 includes additional requirements and guidance to those in this proposed SAS regarding communications about relevant ethical requirements with component auditors.

A39. Based on the nature and circumstances of the audit engagement, certain law, regulation, or aspects of relevant ethical requirements, such as those pertaining to noncompliance with laws or regulations, may be relevant to the engagement (for example, laws or regulations dealing with money laundering, corruption, or bribery).

A40. The firm's information system and the resources provided by the firm may assist the engagement team in understanding and fulfilling relevant ethical requirements applicable to the nature and circumstances of the audit engagement. For example, the firm may do the following:

- Communicate the independence requirements to engagement teams
- Provide training for engagement teams on relevant ethical requirements

²⁷ Paragraphs .16 and .A15–.A21 of AU-C section 200.

- Establish manuals and guides (that is, intellectual resources) containing the provisions of the relevant ethical requirements and guidance on how they are applied in the nature and circumstances of the firm and its engagements
- Assign personnel to manage and monitor compliance with relevant ethical requirements (for example, proposed SQMS *A Firm's System of Quality Management* requires that the firm obtains, at least annually, a documented confirmation of compliance with the independence requirements from all personnel required by relevant ethical requirements to be independent) or provide consultation on matters related to relevant ethical requirements
- Establish policies or procedures for engagement team members to communicate relevant and reliable information to appropriate parties within the firm or to the engagement partner, such as policies or procedures for engagement teams to
 - communicate information about client engagements and the scope of services, including non-assurance services, to enable the firm to identify threats to independence during the period of the engagement and during the period covered by the subject matter
 - communicate circumstances and relationships that may create a threat to independence, so that the firm can evaluate whether such a threat is at an acceptable level and, if it is not, address the threat by eliminating it or reducing it to an acceptable level
 - promptly communicate any breaches of the relevant ethical requirements, including those related to independence

A41. The engagement partner may take into account the information, communication, and resources described in paragraph A39 when determining whether the engagement partner may depend on the firm's policies or procedures in complying with relevant ethical requirements.

A42. Open and robust communication between the members of the engagement team about relevant ethical requirements may also assist in

- drawing the attention of engagement team members to relevant ethical requirements that may be of particular significance to the audit engagement, and
- keeping the engagement partner informed about matters relevant to the engagement team's understanding and fulfillment of relevant ethical requirements and the firm's related policies or procedures.

Identifying and Evaluating Threats to Compliance With Relevant Ethical Requirements (Ref: par. 17–18)

A43. In accordance with proposed SQMS *A Firm's System of Quality Management*, the firm's responses to address the quality risks in relation to relevant ethical requirements, including those related to independence for engagement team members, include policies or procedures for identifying, evaluating, and addressing threats to compliance with the relevant ethical requirements.

A44. Relevant ethical requirements may contain provisions regarding the identification and evaluation of threats and how they are to be dealt with.

Breaches of Relevant Ethical Requirements (Ref: par. 19)

A45. In accordance with proposed SQMS *A Firm's System of Quality Management*, the firm is required to establish policies or procedures for identifying, communicating, evaluating, and reporting of any breaches of relevant ethical requirements and appropriately responding to the causes and consequences of the breaches in a timely manner.

Taking Appropriate Action (Ref: par. 20)

A46. Examples of appropriate actions may include the following:

- Following the firm's policies or procedures regarding breaches of relevant ethical requirements, including communicating to or consulting with the appropriate individuals so that appropriate action can be taken, including as applicable, disciplinary action.
- Communicating with those charged with governance.
- Communicating with regulatory authorities or professional bodies. In some circumstances, communication with regulatory authorities may be required by law or regulation.
- Seeking legal advice.
- Withdrawing from the audit engagement, when withdrawal is possible under applicable law or regulation.

Prior to Dating the Auditor's Report (Ref: par. 21)

A47. AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*, requires that the auditor's report include a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and that the auditor has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.²⁸ Performing the procedures required by paragraphs 16–21 of this proposed SAS provides the basis for these statements in the auditor's report.

Considerations Specific to Governmental Audit Organizations

A48. Law or regulation may provide safeguards for the independence of governmental audit organizations and the auditors they employ. However, in the absence of law or regulation, governmental audit organizations may establish supplemental safeguards to assist the auditor or audit organization in maintaining independence. Additionally, when law or regulation does not permit withdrawal from the engagement, the auditor may disclose in the auditor's report the circumstances affecting the auditor's independence.

²⁸ Paragraph .28c of AU-C section 700.

Acceptance and Continuance of Client Relationships and Audit Engagements (Ref: par. 22–24)

A49. Proposed SQMS *A Firm's System of Quality Management* requires the firm to establish quality objectives that address the acceptance and continuance of client relationships and specific engagements.

A50. Information such as the following may assist the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate:

- The integrity and ethical values of the principal owners, key management, and those charged with governance of the entity
- Whether sufficient and appropriate resources are available to perform the engagement
- Whether management and those charged with governance have acknowledged their responsibilities in relation to the engagement
- Whether the engagement team has the competence and capabilities, including sufficient time, to perform the engagement
- Whether significant matters that have arisen during the current or previous engagement have implications for continuing the engagement

A51. Under proposed SQMS *A Firm's System of Quality Management*, for acceptance and continuance decisions, the firm is required to make judgments about the firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements. The engagement partner may use the information considered by the firm in this regard in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate. If the engagement partner has concerns regarding the appropriateness of the conclusions reached, the engagement partner may discuss the basis for those conclusions with those involved in the acceptance and continuance process.

A52. If the engagement partner is directly involved throughout the firm's acceptance and continuance process, the engagement partner will be aware of the information obtained or used by the firm in reaching the related conclusions. Such direct involvement may also provide a basis for the engagement partner's determination that the firm's policies or procedures have been followed and that the conclusions reached are appropriate.

A53. Information obtained during the acceptance and continuance process may assist the engagement partner in complying with the requirements of this proposed SAS and making informed decisions about appropriate courses of action. Such information may include the following:

- Information about the size, complexity, and nature of the entity, including whether it is a group audit, the industry in which it operates, and the applicable financial reporting framework
- The entity's timetable for reporting, such as at interim and final stages

- In relation to group audits, the nature of the control relationships between the parent and its components
- Whether there have been changes in the entity or in the industry in which the entity operates since the previous audit engagement that may affect the nature of resources required, as well as the manner in which the work of the engagement team will be directed, supervised, and reviewed

A54. Information obtained during acceptance and continuance may also be relevant in complying with the requirements of other AU-C sections, as well as this proposed SAS, for example, with respect to the following:

- Establishing an understanding of the terms of the audit engagement, as required by AU-C section 210, *Terms of Engagement*²⁹
- Identifying and assessing risks of material misstatement, whether due to error or fraud, in accordance with AU-C section 315 and AU-C section 240, *Consideration of Fraud in a Financial Statement Audit*
- Understanding the group, its components, and their environments, in the case of an audit of group financial statements in accordance with AU-C section 600, and directing, supervising, and reviewing the work of component auditors
- Determining whether, and how, to involve an auditor's specialist in accordance with AU-C section 620
- The entity's governance structure in accordance with AU-C section 260, *The Auditor's Communication With Those Charged With Governance*, and AU-C section 265, *Communicating Internal Control Related Matters Identified in an Audit*

A55. Law, regulation, or relevant ethical requirements may require the successor auditor to request, prior to accepting the audit engagement, the predecessor auditor to provide known information regarding any facts or circumstances that, in the predecessor auditor's judgment, the successor auditor needs to be aware of before deciding whether to accept the engagement. In some circumstances, the predecessor auditor may be required, on request by the proposed successor auditor, to provide information regarding identified or suspected noncompliance with laws and regulations to the proposed successor auditor.

A56. In circumstances when the firm is obligated by law or regulation to accept or continue an audit engagement, the engagement partner may take into account information obtained by the firm about the nature and circumstances of the engagement.

A57. In deciding on the necessary action, the engagement partner and the firm may conclude that it is appropriate to continue with the audit engagement and, if so, determine what additional steps are necessary at the engagement level (for example, the assignment of more staff or staff with specific expertise). If the engagement partner has further concerns or is not satisfied that the matter has been appropriately resolved, the firm's policies or procedures for resolving differences of opinion may be applicable.

²⁹ Paragraph .09 of AU-C section 210, *Terms of Engagement*.

Considerations Specific to Governmental Audit Organizations (Ref: par. 22–24)

A58. When the auditor is a government audit organization, the auditor may be appointed in accordance with law or regulation, and the auditor may not need to establish all policies or procedures regarding the acceptance and continuance of audit engagements. Nevertheless, the requirements and considerations for the acceptance and continuance of client relationships and engagements as set out in paragraphs 22–24 and A48–A56 may be valuable to such auditors in performing risk assessments and in carrying out reporting responsibilities.

Engagement Resources (Ref: par. 25–28)

A59. Under proposed SQMS *A Firm's System of Quality Management*, the resources assigned or made available by the firm to support the performance of audit engagements include

- human resources,
- technological resources, and
- intellectual resources.

A60. Resources for an audit engagement are primarily assigned or made available by the firm, although there may be circumstances when the engagement team directly obtains resources for the audit engagement. For example, this may be the case when a component auditor is required by statute, regulation, or for another reason to express an audit opinion on the financial statements of a component, and the component auditor is also appointed by component management to perform audit procedures on behalf of the group engagement team.³⁰ In such circumstances, the firm's policies or procedures may require the engagement partner to take different actions, such as requesting information from the component auditor, to determine whether sufficient and appropriate resources are assigned or made available.

A61. A relevant consideration for the engagement partner, in complying with the requirements in paragraphs 25 and 26, may be whether the resources assigned or made available to the engagement team enable fulfillment of relevant ethical requirements, including ethical principles such as professional competence and due care.

Human Resources

A62. Human resources include members of the engagement team (see also paragraphs A5 and A15–A21) and, when applicable, an auditor's external specialist and individuals from within the entity's internal audit function who provide direct assistance on the audit.

Technological Resources

A63. The use of technological resources on the audit engagement may assist the auditor in obtaining sufficient appropriate audit evidence. Technological resources may include tools that allow the auditor to more effectively and efficiently manage the audit. Technological tools may also allow the auditor to evaluate large amounts of data more easily to, for example, provide deeper insights, identify unusual trends, or more effectively challenge management's assertions, which enhances the ability of the auditor to exercise professional skepticism. Technological tools

³⁰ See paragraph .03 of AU-C section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*.

may also be used to conduct meetings and provide communication tools to the engagement team. Inappropriate use of technological resources may, however, increase the risk of overreliance on the information produced for decision-making purposes or may create threats to complying with relevant ethical requirements, for example, requirements related to confidentiality.

A64. The firm's policies or procedures may include required considerations or responsibilities for the engagement team when using firm-approved technological tools to perform audit procedures and may require, depending on the tool used, the involvement of individuals with specialized skills or expertise in evaluating or analyzing the output.

A65. When the engagement partner requires individuals from another firm to use specific automated tools and techniques when performing audit procedures, communications with those individuals may indicate that the use of such automated tools and techniques needs to comply with the engagement team's instructions.

A66. The firm's policies or procedures may specifically prohibit the use of certain IT applications or features of IT applications (for example, software that has not yet been specifically approved for use by the firm). Alternatively, the firm's policies or procedures may require the engagement team to take certain actions before using an IT application that is not firm-approved to determine it is appropriate for use, for example, by requiring

- the engagement team to have appropriate competence and capabilities to use the technological resource.
- testing of the operation and security of the IT application.
- specific documentation to be included in the audit file.

A67. The engagement partner may exercise professional judgment in considering whether the use of an IT application on the audit engagement is appropriate in the context of the engagement, and if so, how the IT application is to be used. Factors that may be considered in determining whether a particular IT application that has not been specifically approved for use by the firm is appropriate for use in the audit engagement include whether

- use and security of the IT application complies with the firm's policies or procedures.
- the IT application operates as intended.
- personnel have the competence and capabilities required to use the IT application.

Intellectual Resources

A68. Intellectual resources include, for example, audit methodologies, implementation tools, auditing guides, model programs, templates, checklists, or forms.

A69. The use of intellectual resources on the audit engagement may facilitate the consistent application and understanding of professional standards, law and regulation, and related firm policies or procedures. For this purpose, the engagement team may be required, in accordance with the firm's policies or procedures, to use the firm's audit methodology and specific tools and guidance. The engagement team may also consider whether the use of other intellectual resources is appropriate and relevant based on the nature and circumstances of the engagement, for example, an industry-specific methodology or related guides and performance aids.

Sufficient and Appropriate Resources to Perform the Engagement (Ref: par. 25)

A70. In determining whether sufficient and appropriate resources to perform the engagement have been assigned or made available to the engagement team, ordinarily, the engagement partner may depend on the firm's related policies or procedures (including resources) as described in paragraph A6. For example, based on information communicated by the firm, the engagement partner may be able to depend on the firm's technological development, implementation, and maintenance programs when using firm-approved technology to perform audit procedures.

Competence and Capabilities of the Engagement Team (Ref: par. 26)

A71. When determining that the engagement team has the appropriate competence and capabilities, the engagement partner may take into consideration such matters as the team's

- understanding of, and practical experience with, audit engagements of a similar nature and complexity through appropriate training and participation.
- understanding of professional standards and applicable legal and regulatory requirements.
- expertise in specialized areas of accounting or auditing.
- expertise in IT used by the entity or automated tools or techniques that are to be used by the engagement team in planning and performing the audit engagement.
- knowledge of relevant industries in which the entity being audited operates.
- ability to exercise professional skepticism and professional judgment.
- understanding of the firm's policies or procedures.

A72. Internal auditors and an auditor's external specialist are not members of the engagement team. AU-C section 610³¹ and AU-C section 620³² include requirements and guidance relating to the assessment of the competence and capabilities of internal auditors and an auditor's external specialist, respectively.

Project Management

A73. In situations in which there are many engagement team members, for example, in an audit of a larger or more complex entity, the engagement partner may involve an individual who has specialized skills or knowledge in project management, supported by appropriate technological and intellectual resources of the firm. Conversely, in an audit of a less complex entity with few engagement team members, project management may be achieved by a member of the engagement team through less formal means.

A74. Project management techniques and tools may support the engagement team in managing the quality of the audit engagement by, for example

³¹ Paragraph .13 of AU-C section 610.

³² Paragraph .09 of AU-C section 620.

- increasing the engagement team’s ability to exercise professional skepticism through alleviating budget or time constraints that may otherwise impede the exercise of professional skepticism;
- facilitating timely performance of audit work to effectively manage time constraints at the end of the audit process when more difficult or contentious matters may arise;
- monitoring the progress of the audit against the audit plan,³³ including the achievement of key milestones, which may assist the engagement team in being proactive in identifying the need for making timely adjustments to the audit plan and the assigned resources; or
- facilitating communication among members of the engagement team, for example, coordinating arrangements with component auditors and auditor’s experts.

Insufficient or Inappropriate Resources (Ref: par. 27)

A75. Proposed SQMS *A Firm’s System of Quality Management* addresses the firm’s commitment to quality through its culture that exists throughout the firm, which recognizes and reinforces the firm’s role in serving the public interest by consistently performing quality engagements, and the importance of quality in the firm’s strategic decisions and actions, including the firm’s financial and operational priorities. Proposed SQMS *A Firm’s System of Quality Management* also addresses the firm’s responsibilities for planning for resource needs and obtaining, allocating, or assigning resources in a manner that is consistent with the firm’s commitment to quality. However, in certain circumstances, the firm’s financial and operational priorities may place constraints on the resources assigned or made available to the engagement team. In such circumstances, these constraints do not override the engagement partner’s responsibility for achieving quality at the engagement level, including for determining that the resources assigned or made available by the firm are sufficient and appropriate to perform the audit engagement.

A76. In an audit of group financial statements, when there are insufficient or inappropriate resources in relation to work being performed at a component by a component auditor, the engagement partner may discuss the matter with the component auditor, management, or the firm to make sufficient and appropriate resources available.

A77. The engagement partner’s determination of whether additional engagement level resources are required is a matter of professional judgment and is influenced by the requirements of this proposed SAS and the nature and circumstances of the audit engagement. As described in paragraph A11, in certain circumstances, the engagement partner may determine that the firm’s responses to quality risks are ineffective in the context of the specific engagement, including that certain resources assigned or made available to the engagement team are insufficient. In those circumstances, the engagement partner is required to take appropriate action, including communicating such information to the appropriate individuals in accordance with paragraph 27 and paragraph 39c. For example, if an audit software program provided by the firm has not incorporated new or revised audit procedures regarding recently issued industry regulation, timely communication of such information to the firm enables the firm to take steps to update and reissue the software promptly or to provide an alternative resource that enables the

³³ See paragraph .09 of AU-C section 300.

engagement team to comply with the new regulation in the performance of the audit engagement.

A78. If the resources assigned or made available are insufficient or inappropriate in the circumstances of the engagement and additional or alternative resources have not been made available, appropriate actions may include the following:

- Changing the planned approach to the nature, timing, and extent of direction, supervision, and review (see also paragraph A94)
- Discussing an extension to reporting deadlines with management or those charged with governance, when an extension is possible under applicable law or regulation
- Following the firm's policies or procedures for resolving differences of opinion if the engagement partner does not obtain the necessary resources for the audit engagement
- Following the firm's policies or procedures for withdrawing from the audit engagement, when withdrawal is possible under applicable law or regulation

Considerations Specific to Audits of Governmental Entities (Ref: par. 25–28)

A79. For audits of governmental entities, competence may include skills that are necessary to comply with applicable law or regulation, such as knowledge of *Government Auditing Standards* and an understanding of the applicable reporting requirements, including reporting to the legislature or other governing body or reporting in the public interest. The scope of a governmental audit may include, for example, additional requirements with respect to detecting misstatements that result from violations of provisions of contracts or grant agreements that could have a direct and material effect of the determination of financial statement amounts or the need to examine and report on internal control over financial reporting or compliance.

Engagement Performance

Scalability (Ref: par. 29)

A80. When an audit is not carried out entirely by the engagement partner, or in an audit of an entity whose nature and circumstances are more complex, it may be necessary for the engagement partner to assign direction, supervision, and review to other members of the engagement team. However, as part of the engagement partner's overall responsibility for managing and achieving quality on the audit engagement and to be sufficiently and appropriately involved, the engagement partner is required to determine that the nature, timing, and extent of direction, supervision, and review is undertaken in accordance with paragraph 30. In such circumstances, personnel or members of the engagement team, including component auditors, may provide information to the engagement partner to enable the engagement partner to make the determination required by paragraph 30.

Direction, Supervision, and Review (Ref: par. 30)

A81. Under proposed SQMS *A Firm's System of Quality Management*, the firm is required to establish a quality objective that addresses the nature, timing, and extent of the direction and supervision of engagement teams and review of their work. Proposed SQMS *A Firm's System of Quality Management* also requires that such direction, supervision, and review is planned and performed on the basis that the work performed by less experienced members of the engagement team is directed, supervised, and reviewed by more experienced engagement team members.

A82. Direction and supervision of the engagement team and the review of the work of the engagement team are firm-level responses that are implemented at the engagement level, of which the nature, timing, and extent may be further tailored by the engagement partner in managing the quality of the audit engagement. Accordingly, the approach to direction, supervision, and review will vary from one engagement to the next, taking into account the nature and circumstances of the engagement. The approach will generally include a combination of addressing the firm's policies or procedures and engagement-specific responses.

A83. The approach to the direction and supervision of the members of the engagement team and the review of their work provides support for the engagement partner in fulfilling the requirements of this proposed SAS and in concluding that the engagement partner has been sufficiently and appropriately involved throughout the audit engagement in accordance with paragraph 40.

A84. Ongoing discussion and communication among members of the engagement team allows less experienced engagement team members to raise questions with more experienced engagement team members (including the engagement partner) in a timely manner and enables effective direction, supervision, and review in accordance with paragraph 30.

Direction

A85. Direction of the engagement team may involve informing the members of the engagement team of their responsibilities, such as the following:

- Contributing to the management and achievement of quality at the engagement level through their personal conduct, communication, and actions
- Maintaining a questioning mind and being aware of unconscious or conscious auditor biases in exercising professional skepticism when gathering and evaluating audit evidence (see paragraph A34)
- Fulfilling relevant ethical requirements
- The responsibilities of respective partners when more than one partner is involved in the conduct of an audit engagement
- The responsibilities of respective engagement team members to perform audit procedures and of more experienced engagement team members to direct, supervise, and review the work of less experienced engagement team members
- Understanding the objectives of the work to be performed and the detailed instructions regarding the nature, timing, and extent of planned audit procedures as set forth in the overall audit strategy and audit plan
- Addressing threats to the achievement of quality, and the engagement team's expected response, for example, the threat that budget constraints or resource constraints result in the engagement team members inappropriately modifying planned audit procedures or failing to perform planned audit procedures

Supervision

A86. Supervision may include matters such as the following:

Proposed SAS *Quality Management for Engagements Conducted in Accordance With GAAS*

- Tracking the progress of the audit engagement, which includes monitoring
 - the progress against the audit plan;
 - whether the objective of work performed has been achieved; and
 - the ongoing adequacy of assigned resources
- Taking appropriate action to address issues arising during the engagement, including, for example, reassigning planned audit procedures to more experienced engagement team members when issues are more complex than initially anticipated
- Identifying matters for consultation or consideration by more experienced engagement team members during the audit engagement
- Providing coaching and on-the-job training to help engagement team members develop skills or competencies
- Creating an environment where engagement team members raise concerns without fear of reprisals

Review

A87. Review of the engagement team’s work provides support for the conclusion that the requirements of this proposed SAS have been addressed.

A88. Review of the engagement team’s work consists of consideration of whether, for example

- the work has been performed in accordance with the firm’s policies or procedures, professional standards, and applicable legal and regulatory requirements;
- significant matters have been raised for further consideration;
- appropriate consultations have taken place, and the resulting conclusions have been documented and implemented;
- there is a need to revise the nature, timing, and extent of work performed;
- the work performed supports the conclusions reached and is appropriately documented;
- the evidence obtained is sufficient and appropriate to provide a basis for the auditor’s opinion; and
- the objectives of the audit procedures have been achieved.

A89. The firm’s policies or procedures may contain specific requirements regarding

- the nature, timing, and extent of review of audit documentation;
- different types of review that may be appropriate in different situations (for example, review of each individual working paper or selected working papers); and
- which members of the engagement team are required to perform the different types of review.

The Engagement Partner's Review (Ref: par. 30–34)

A90. As required by AU-C section 300, the engagement partner reviews the overall audit strategy and audit plan.³⁴ As required by AU-C section 230, the engagement partner documents the date and extent of the review.³⁵

A91. Timely review of documentation by the engagement partner at appropriate stages throughout the audit engagement enables significant matters to be resolved to the engagement partner's satisfaction on or before the date of the auditor's report. The engagement partner need not review all audit documentation. The engagement partner exercises professional judgment in determining the extent of documentation to be reviewed, for example, when determining the nature and extent of the review of component auditor documentation in a group audit.

A92. The engagement partner exercises professional judgment in identifying the areas of significant judgment made by the engagement team. The firm's policies or procedures may specify certain matters that are commonly expected to be significant judgments. Significant judgments in relation to the audit engagement may include matters related to the overall audit strategy and audit plan for undertaking the engagement, the execution of the engagement, and the overall conclusions reached by the engagement team. Examples follow:

- Matters related to planning the engagement, such as matters related to determining materiality
 - The composition of the engagement team, including
 - personnel using expertise in a specialized area of accounting or auditing
 - the use of personnel from service delivery centers
 - The decision to involve an auditor's specialist, including the decision to involve an external specialist
- The engagement team's consideration of information obtained in the acceptance and continuance process and proposed responses to that information
- The engagement team's risk assessment process, including situations in which consideration of inherent risk factors and the assessment of inherent risk requires significant judgment by the engagement team
- The engagement team's consideration of related party relationships and transactions and disclosures
- Results of the procedures performed by the engagement team on significant areas of the engagement, for example, conclusions concerning certain accounting estimates, accounting policies, or going concern considerations
- The engagement team's evaluation of the work performed by specialists and conclusions drawn therefrom
- In group audit situations

³⁴ Paragraph .11 of AU-C section 300, as amended by this proposed SAS.

³⁵ Paragraph .09c of AU-C section 230.

- the proposed overall group audit strategy and group audit plan;
 - decisions about the involvement of component auditors, including how to direct and supervise them and review their work, including, for example, when there are areas of higher assessed risk of material misstatement of the financial information of a component; and
 - the evaluation of work performed by component auditors and the conclusions drawn therefrom
- How matters affecting the overall audit strategy and audit plan have been addressed
 - The significance and disposition of corrected and uncorrected misstatements identified during the engagement
 - The proposed audit opinion and matters to be communicated in the auditor’s report, for example, key audit matters, or a “Material Uncertainty Related to Going Concern” paragraph.

A93. The engagement partner exercises professional judgment in determining other matters to review, for example, based on

- the nature and circumstances of the audit engagement.
- which engagement team member performed the work.
- matters relating to recent inspection findings.
- the requirements of the firm’s policies or procedures.

Nature, Timing, and Extent

A94. The nature, timing, and extent of the direction, supervision, and review are required to be planned and performed in accordance with the firm’s policies or procedures, as well as professional standards and applicable legal and regulatory requirements. For example, the firm’s policies or procedures may include the following:

- Work planned to be performed at an interim date is to be directed, supervised, and reviewed at the same time as the performance of the procedures, rather than at the end of the period, so that any necessary corrective action can be taken in a timely manner.
- Certain matters are to be reviewed by the engagement partner, and the firm may specify the circumstances or engagements in which such matters are expected to be reviewed.

Scalability

A95. The following are examples of factors that may influence the firm’s approach to direction, supervision, and review:

- The engagement team member’s previous experience with the entity and the area to be audited. For example, if the work related to the entity’s information system is being performed by the same engagement team member who performed the work in the prior period and there are no significant changes to the information system, the extent and

frequency of the direction and supervision of the engagement team member may be less, and the review of the related working papers may be less detailed.

- The complexity of the audit engagement. For example, if significant events have occurred that make the audit engagement more complex, the extent and frequency of the direction and supervision of the engagement team member may be greater, and the review of the related working papers may be more detailed.
- The assessed risks of material misstatement. For example, a higher assessed risk of material misstatement may require a corresponding increase in the extent and frequency of the direction and supervision of engagement team members and a more detailed review of their work.
- The competence and capabilities of the individual engagement team members performing the audit work. For example, less experienced engagement team members may require more detailed instructions and more frequent, or in-person, interactions as the work is performed.
- The manner in which the reviews of the work performed are expected to take place. For example, in some circumstances, remote reviews may not be effective in providing the necessary direction and may need to be supplemented by in-person interactions.
- The structure of the engagement team and the location of engagement team members. For example, direction and supervision of individuals located at service delivery centers and the review of their work may
 - be more formalized and structured than when members of the engagement team are all situated in the same location, or
 - use IT to facilitate the communication between the members of the engagement team.

A96. Identification of changes in the engagement circumstances may warrant reevaluation of the planned approach to the nature, timing, or extent of direction, supervision, or review. For example, if the assessed risk of material misstatement at the financial statement level increases because of a complex transaction, the engagement partner may need to change the planned level of review of the work related to the transaction.

A97. In accordance with paragraph 30*b*, the engagement partner is required to determine that the approach to direction, supervision, and review is responsive to the nature and circumstances of the audit engagement. For example, if a more experienced engagement team member becomes unavailable to participate in the supervision and review of the engagement team, the engagement partner may need to increase the extent of supervision and review of the less experienced engagement team members.

Review of Communications to Management, Those Charged With Governance, or Regulatory Authorities (Ref: par. 34)

A98. The engagement partner uses professional judgment in determining which written communications to review, taking into account the nature and circumstances of the audit engagement. For example, it may not be necessary for the engagement partner to review

communications between the engagement team and management in the ordinary course of the audit.

Consultation (Ref: par. 35)

A99. Proposed SQMS *A Firm's System of Quality Management* requires the firm to establish a quality objective that addresses consultation on difficult or contentious matters and how the conclusions agreed are implemented. Consultation may be appropriate or required, for example, for

- issues that are complex or unfamiliar (for example, issues related to an accounting estimate with a high degree of estimation uncertainty);
- significant risks, such as those that required significant auditor attention;
- significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual;
- limitations imposed by management; and
- noncompliance with laws or regulations.

A100. Effective consultation on significant technical, ethical, and other matters within the firm or, where applicable, outside the firm, may be achieved when those consulted

- are given all the relevant facts that will enable them to provide informed advice and
- have appropriate knowledge, seniority, and experience.

A101. It may be appropriate for the engagement team, in the context of the firm's policies or procedures, to consult outside the firm, for example, in areas where the firm lacks appropriate internal resources. The engagement team may take advantage of advisory services provided by firms, professional and regulatory bodies, or commercial organizations that provide relevant quality control services.

A102. The need for consultation outside the engagement team on a difficult or contentious matter may be an indicator that the matter is a key audit matter.³⁶

Engagement Quality Review (Ref: par. 36)

A103. Proposed SQMS *A Firm's System of Quality Management* contains requirements that the firm establish policies or procedures addressing engagement quality reviews in accordance with proposed SQMS *Engagement Quality Reviews*³⁷ and requiring an engagement quality review for certain types of engagements.³⁸ Proposed SQMS *Engagement Quality Reviews* deals with the appointment and eligibility of the engagement quality reviewer and the engagement quality reviewer's responsibilities relating to performing and documenting an engagement quality review.

³⁶ Paragraphs .09 and .A13b of AU-C section 701.

³⁷ Proposed SQMS *Engagement Quality Reviews*.

³⁸ Paragraph 35f of proposed SQMS *A Firm's System of Quality Management*.

Completion of the Engagement Quality Review Before Dating of the Auditor's Report (Ref: par. 36d)

A104. AU-C section 700 requires the auditor's report to be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements.³⁹ If applicable to the audit engagement, proposed SQMS *Engagement Quality Reviews* and this proposed SAS require that the engagement partner be precluded from dating the engagement report until notification has been received from the engagement quality reviewer that the engagement quality review is complete. For example, if the engagement quality reviewer has communicated to the engagement partner concerns about the significant judgments made by the engagement team or that the conclusions reached thereon were not appropriate, then the engagement quality review is not complete.⁴⁰

A105. An engagement quality review that is conducted in a timely manner at appropriate stages during the audit engagement may assist the engagement team in promptly resolving matters raised to the engagement quality reviewer's satisfaction on or before the date of the auditor's report.

A106. Frequent communications between the engagement team and the engagement quality reviewer throughout the audit engagement may assist in facilitating an effective and timely engagement quality review. In addition to discussing significant matters with the engagement quality reviewer, the engagement partner may assign responsibility for coordinating requests from the engagement quality reviewer to another member of the engagement team.

Differences of Opinion (Ref: par. 37–38)

A107. Proposed SQMS *A Firm's System of Quality Management* requires the firm to establish a quality objective that addresses differences of opinion that arise within the engagement team or between the engagement team and the engagement quality reviewer or individuals performing activities within the firm's system of quality management. Proposed SQMS *A Firm's System of Quality Management* also requires that differences of opinion are brought to the attention of the firm and resolved. For example, a component auditor may be instructed to communicate differences of opinion to the group engagement team.

A108. In some circumstances, the engagement partner may not be satisfied with the resolution of the difference of opinion. In such circumstances, appropriate actions for the engagement partner may include, for example

- seeking legal advice or
- withdrawing from the audit engagement, when withdrawal is possible under applicable law or regulation.

Monitoring and Remediation (Ref: par. 39)

A109. Proposed SQMS *A Firm's System of Quality Management* sets out requirements for the firm's monitoring and remediation process. Proposed SQMS *A Firm's System of Quality Management* requires the firm to communicate to engagement teams information about the firm's

³⁹ Paragraph .43 of AU-C section 700.

⁴⁰ Paragraph 21b of proposed SQMS *Engagement Quality Review*.

monitoring and remediation process to enable them to take prompt and appropriate action in accordance with their responsibilities. Further, information provided by members of the engagement team may be used by the firm in the firm's monitoring and remediation process, and exercising professional judgment and professional skepticism while conducting the audit may assist the members of the engagement team in remaining alert for information that may be relevant to that process.

A110. Information provided by the firm may be relevant to the audit engagement when, for example, it relates to findings on another engagement performed by the engagement partner or other members of the engagement team, findings from the local firm office, or inspection results of previous audits of the entity.

A111. In considering information communicated by the firm through its monitoring and remediation process and how it may affect the audit engagement, the engagement partner may consider the remedial actions designed and implemented by the firm to address deficiencies and, to the extent relevant to the nature and circumstances of the engagement, communicate accordingly to the engagement team. The engagement partner may also determine whether additional remedial actions are needed at the engagement level. For example, the engagement partner may determine that

- an auditor's specialist is needed, or
- the nature, timing, and extent of direction, supervision, and review needs to be enhanced in an area of the audit where deficiencies have been identified.

If an identified deficiency does not affect the quality of the audit (for example, if it relates to a technological resource that the engagement team did not use), then no further action may be needed.

A112. A deficiency in the firm's system of quality management does not necessarily indicate that an audit engagement was not performed in accordance with professional standards and applicable legal and regulatory requirements or that the auditor's report was not appropriate in the circumstances.

Taking Overall Responsibility for Managing and Achieving Quality (Ref: par. 40)

A113. Proposed SQMS *A Firm's System of Quality Management* requires the firm to establish a quality objective addressing the engagement team's understanding and fulfillment of their responsibilities in connection with the engagement. Proposed SQMS *A Firm's System of Quality Management* further requires that the quality objective include the overall responsibility of engagement partners for managing and achieving quality on the engagement and being sufficiently and appropriately involved throughout the engagement.

A114. Relevant considerations in addressing paragraph 40 include determining how the engagement partner has complied with the requirements of this proposed SAS, given the nature and circumstances of the audit engagement and how the audit documentation evidences the engagement partner's involvement throughout the audit engagement, as described in paragraph A118.

A115. Indicators that the engagement partner may not have been sufficiently and appropriately involved include, for example, the following:

- Lack of timely review by the engagement partner of the audit engagement planning, including reviewing the assessment of risks of material misstatement and the design of those responses to those risks towards the end of the audit
- Evidence that assignees were not provided necessary instructions and relevant information, such as not being adequately informed about the nature of their responsibilities and authority, the scope of the work being assigned and the objectives thereof
- A lack of evidence of the engagement partner's direction and supervision of the other members of the engagement team and the review of their work

A116. If the engagement partner's involvement does not provide the basis for determining that the significant judgments made and the conclusions reached are appropriate, the engagement partner will not be able to reach the determination required by paragraph 40. In addition to considering firm policies or procedures that may set forth the required actions to be taken in such circumstances, appropriate actions that the engagement partner may take, include, for example

- updating and changing the audit plan;
- reevaluating the planned approach to the nature and extent of review and modifying the planned approach to increase the involvement of the engagement partner; or
- consulting with personnel assigned operational responsibility for the relevant aspect of the firm's system of quality management.

Documentation (Ref: par. 41)

A117. In accordance with AU-C section 230,⁴¹ audit documentation provides evidence that the audit complies with GAAS. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit. Further, it is unnecessary for the auditor to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the audit file.

A118. Documentation of the performance of the requirements of this proposed SAS, including evidencing the involvement of the engagement partner and the engagement partner's determination in accordance with paragraph 40, may be accomplished in different ways depending on the nature and circumstances of the audit engagement. Examples follow:

- Direction of the engagement team can be documented through sign-offs of the audit plan and project management activities.
- Minutes from formal meetings of the engagement team may provide evidence of the clarity, consistency, and effectiveness of the engagement partner's communications and other actions regarding culture and expected behaviors that demonstrate the firm's commitment to quality.
- Agendas from discussions between the engagement partner and other members of the engagement team and, when applicable, the engagement quality reviewer, and related sign-offs and records of the time the engagement partner spent on the engagement, may

⁴¹ Paragraph .A9 of AU-C section 230.

provide evidence of the engagement partner's involvement throughout the audit engagement and supervision of other members of the engagement team.

- Sign-offs by the engagement partner and other members of the engagement team provide evidence that the working papers were reviewed.

A119. When dealing with circumstances that may pose risks to achieving quality on the audit engagement, the exercise of professional skepticism, and the documentation of the auditor's consideration thereof, may be important. For example, if the engagement partner obtains information that may have caused the firm to decline the engagement (see paragraph 24), the documentation may include explanations of how the engagement team dealt with the circumstance.

A120. Documentation of consultations with other professionals that involve difficult or contentious matters that is sufficiently complete and detailed contributes to an understanding of

- the nature and scope of the issue on which consultation was sought, and
- the results of the consultation, including any decisions taken, the basis for those decisions, and how they were implemented.

Appendix – Amendments to Various Statements on Auditing Standards, as Amended, and Statement on Standards for Attestation Engagements No. 18, *Attestation Standards: Clarification and Recodification*, as Amended, section 105, *Concepts Common to All Attestation Engagements*, in AICPA Professional Standards

Amendment to Statement on Auditing Standards (SAS) No. 117, *Compliance Audits*, as Amended

(*Boldface italics* denotes new language. Deleted text is in ~~strikethrough~~.)

AU-C section 935, *Compliance Audits*

[No amendment to paragraphs .01–.A34.]

.A35 ~~Section 220, *Proposed Statement on Auditing Standards Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*~~, requires that, on or before the date of the auditor’s report, the engagement partner *determine*, through a 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.^{fn 20} When an engagement quality ~~control~~ review is performed, ~~section 220 *proposed Statement on Auditing Standards Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*~~ requires that the *engagement partner not date the* auditor’s report ~~not be released prior to~~ *until* the completion of the engagement quality ~~control~~ review.^{fn 21}

^{fn 20} ~~See paragraph Paragraph 1932 of section 220, *proposed SAS Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, for further discussion.~~

^{fn 21} Paragraph ~~2136d~~ of ~~section 220~~ *proposed SAS Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

[No further amendment to AU-C section 935.]

1. This amendment is effective for compliance audits for fiscal periods ending on or after December 15, 2023. This date is provisional but will not be earlier than December 15, 2023.

Amendments to Various Sections in SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*, as Amended

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(Boldface italics denotes new language. Deleted text is in strikethrough.)

AU-C Section 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards

[No amendment to paragraphs .01–.A19.]

.A20 ~~QC section 10~~**Proposed Statement on Quality Management Standards (SQMS) A Firm's System of Quality ~~Control~~ Management**, sets out the firm's responsibilities to ~~establish and maintain its~~**design, implement, and operate** a system of quality control for audit engagements, and to establish policies and procedures designed to provide it **management that provides the firm** with reasonable assurance that the firm and its personnel **fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements and conduct engagements in accordance with such standards and requirements. As part of its system of quality management, proposed SQMS A Firm's System of Quality Management requires the firm to establish quality objectives that address the fulfillment of responsibilities in accordance** ~~comply~~ with relevant ethical requirements, including those ~~pertaining~~ **related** to independence.^{fn 7} ~~Section 220~~**Proposed Statement on Auditing Standards (SAS); Quality ~~Control~~ Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards** addresses the engagement partner's responsibilities regarding relevant ethical requirements, **including those related to independence**. These ~~include remaining alert for evidence of noncompliance with relevant ethical requirements by members of the engagement team, determining, in consultation with others in the firm as appropriate, the appropriate action if matters come to the engagement partner's attention, through the firm's system of quality control or otherwise, that indicate that members of the engagement team have not complied with relevant ethical requirements, and forming a conclusion on compliance with independence requirements that apply to the audit engagement.~~^{fn 8} ~~Section 220~~**Proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards** recognizes that **also describes when** the engagement team is entitled to rely on a firm's system of quality control in meeting its responsibilities with respect to quality control procedures applicable to the individual audit engagement, unless the engagement partner determines that it is inappropriate to do so based on information provided by the firm or other parties **may depend on the firm's policies or procedures in managing and achieving quality at the engagement level.**^{fn 9}

^{fn 7} Paragraphs ~~21–25~~**30** of ~~QC section 10~~**proposed Statement on Quality Management Standards A Firm's System of Quality ~~Control~~ Management**.

^{fn 8} Paragraphs ~~416–431~~ of ~~section 220~~**proposed Statement on Auditing Standards (SAS); Quality ~~Control~~ Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards**.

^{fn 9} **Paragraph A10 of proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards**.

[No amendment to paragraphs .A21–.A31. Subsequent footnotes are renumbered.]

.A32 Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous

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audits (provided the auditor has determined whether changes have occurred since the previous audit that may affect its relevance to the current audit¹³) or ***through the information obtained by the firm in the acceptance or continuance of the client relationship or engagement*** firm's quality control procedures for client acceptance or continuance. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared by a specialist employed or engaged by the entity. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions. In addition, in some cases, the absence of information (for example, management's refusal to provide a requested representation) is used by the auditor, and therefore, also constitutes audit evidence. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence.

^{fn 13} [Footnote omitted for purposes of this exposure draft.]

[No further amendment to AU-C section 200.]

2. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2023. This date is provisional but will not be earlier than December 15, 2023.

AU-C Section 210, *Terms of Engagement*

[No amendment to paragraphs .01–.18.]

.A1 Proposed Statement on Quality Management Standards A Firm's System of Quality Management addresses the firm's responsibilities regarding the acceptance and continuance of client relationships and specific engagements. The auditor's responsibilities regarding relevant ethical requirements, ***including those related to independence***, in the context of the acceptance of an audit engagement, insofar as they are within the control of the auditor, are dealt with in ~~section 220~~ ***proposed Statement on Auditing Standards Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards***. This section addresses those matters (or preconditions) that are within the control of the entity and upon which it is necessary for the auditor and the entity's management to agree.

[No further amendment to AU-C section 210.]

3. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2023. This date is provisional but will not be earlier than December 15, 2023.

AU-C Section 230, *Audit Documentation*

[No amendment to paragraphs .01–.02.]

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.03 Audit documentation serves a number of additional purposes, including the following:

- Assisting the engagement team to plan and perform the audit
- Assisting members of the engagement team responsible for supervision to direct and supervise the audit work, and to discharge their review responsibilities in accordance with ~~section 220~~**proposed Statement on Auditing Standards (SAS), Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards**³
- Enabling the engagement team to demonstrate that it is accountable for its work by documenting the procedures performed, the audit evidence examined, and the conclusions reached
- Retaining a record of matters of continuing significance to future audits of the same entity
- Enabling the conduct of **engagement** quality control reviews, **other types of engagement reviews, and monitoring activities under the firm's system of quality management inspections in accordance with QC** ~~section 10, A Firm's System of Quality Control~~
- Enabling the conduct of external inspections in accordance with applicable legal, regulatory, or other requirements
- Assisting an auditor who reviews a predecessor auditor's audit documentation
- Assisting auditors to understand the work performed in the prior year as an aid in planning and performing the current engagement

³ Paragraphs ~~.17-.19~~ **29-33** of ~~section 220~~**proposed Statement on Auditing Standards (SAS), Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.**

[No amendment to paragraphs .04-.A8.]

.A9 Audit documentation provides evidence that the audit complies with GAAS. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit. Further, it is unnecessary for the auditor to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the audit file. For example:

- The existence of an adequately documented audit plan demonstrates that the auditor has planned the audit.
- The existence of a signed engagement letter in the audit file demonstrates that the auditor has agreed to the terms of the audit engagement with management or, when appropriate, those charged with governance.

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- An auditor’s report containing an appropriately qualified opinion on the financial statements demonstrates that the auditor has complied with the requirement to express a qualified opinion under the circumstances in accordance with GAAS.
- Regarding requirements that apply generally throughout the audit, there may be a number of ways in which compliance with them may be demonstrated within the audit file:
 - For example, there may be no single way in which the auditor’s professional skepticism is documented. But the audit documentation may nevertheless provide evidence of the auditor’s exercise of professional skepticism in accordance with GAAS. Such evidence may include specific procedures performed to corroborate management’s responses to the auditor’s inquiries.
 - Similarly, that the engagement partner has taken responsibility for the direction, *and* supervision, *and* performance of the *engagement team and review of their work*^{fn 6} ~~audit in compliance with GAAS~~ may be evidenced in a number of ways within the audit documentation. This may include documentation of *that evidences* the engagement partner’s ~~timely~~ *sufficient and appropriate* involvement in ~~aspects of the audit, such as participation in the engagement team discussions. required by section 315, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement.~~^{fn 6}

^{fn 6} Paragraph 29 of proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.

[No amendment to paragraphs .A10–.A14.]

.A15 ~~Section 220~~ *Proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards contains requirements and guidance on the* ~~requires the auditor to review the audit work performed through review of the~~ audit documentation.⁹ The requirement to document who reviewed the audit work performed and the extent of the review, in accordance with the firm’s policies and procedures addressing review responsibilities does not imply a need for each specific working paper to include evidence of review. The requirement, however, means documenting what audit work was reviewed, who reviewed such work, and when it was reviewed.

^{fn 9} Paragraph 9931 of ~~section 220~~ *proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.*

[No amendment to paragraphs .A16–.A22.]

Matters Arising After the Date of the Auditor’s Report (Ref: par. .14)

.A23 Examples of rare circumstances in which the auditor performs new or additional audit

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procedures or draws new conclusions after the date of the auditor's report include

- when, after the date of the auditor's report, the auditor becomes aware of facts that existed at that date and which, if known at that date, might have caused the financial statements to be revised or the auditor to modify the opinion in the auditor's report.^{fn 11}
- when the auditor concludes that procedures necessary at the time of the audit, in the circumstances then existing, were omitted from the audit of the financial information.^{fn 12}

The resulting changes to the audit documentation are reviewed in accordance with the firm's ~~quality control~~ procedures as required by QC section 10 *under its system of quality management*.

^{fn 11-12} [Footnotes omitted for purposes of this exposure draft.]

Assembly and Retention of the Final Audit File (Ref: par. .16–.18)

.A24 Statutes, regulations, or the audit firm's ~~quality control~~ policies *or procedures under its system of quality management* may specify a period of time shorter than 60 days following the report release date in which this assembly process is to be completed.

[No amendment to paragraphs .A25–.A26.]

.A27 ~~Firms are required to establish policies and procedures for the retention of engagement documentation.~~^{fn-13} Statutes, regulations, or the audit firm's ~~quality control~~ policies *or procedures under its system of quality management* may specify a retention period longer than five years.

^{fn-13} Paragraph .50 of QC section 10.

.A28 An example of a circumstance in which the auditor may find it necessary to modify existing audit documentation or add new audit documentation after file assembly has been completed is the need to clarify existing audit documentation arising from comments received during monitoring ~~inspections performed by internal~~ *activities* or external ~~parties~~ *inspections*.

[No further amendment to AU-C section 230.]

4. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2023. This date is provisional but will not be earlier than December 15, 2023.

AU-C Section 260, *The Auditor's Communication With Those Charged With Governance*

[No amendment to paragraphs .01–.A36.]

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.A37 To the extent not already addressed by the requirements in paragraph .12a–f and related application material, the auditor may consider communicating about other matters discussed with, or considered by, the engagement quality control reviewer, if one has been appointed, ~~in accordance with section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.~~^{fn-14}

^{fn-14} Paragraphs .21–.22 of section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

[No amendment to paragraphs .A38–.A50.]

.A51 Timely communication throughout the audit contributes to the achievement of robust two-way dialogue between those charged with governance and the auditor. However, the appropriate timing for communications will vary with the circumstances of the engagement. Considerations include the significance and nature of the matter, the importance of the matter to those charged with governance, and the action expected to be taken by those charged with governance. The following are examples of the timing of communications for certain matters:

- Communications regarding planning matters may often be made early in the audit engagement and, for an initial engagement, as part of the terms of the engagement.
- It may be appropriate to communicate significant difficulties encountered during the audit as soon as practicable if those charged with governance are able to assist the auditor in overcoming the difficulties or if the difficulties are likely to lead to a modified opinion.
- Communications regarding independence may be appropriate whenever significant judgments are made about threats to independence and related safeguards.
- When section 701 applies, the auditor may communicate preliminary views about key audit matters when discussing the planned scope and timing of the audit (see paragraph .A21); the auditor may also have more frequent communications to further discuss such matters when communicating about significant audit findings.

The following are examples of matters for which communication with those charged with governance may be important prior to issuance of the auditor’s report:

- Uncorrected misstatements accumulated by the auditor and the effect that they may have, individually or in the aggregate, on the opinion in the auditor’s report, including possible implications with respect to future financial statements
- Circumstances or relationships to which the auditor gave significant consideration relating to independence in reaching the conclusion that independence has not been impaired

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- Significant findings or issues from the audit, including the auditor’s views about the qualitative aspects of the entity’s accounting practices
- An expectation by the auditor that the opinion in the auditor’s report will be modified in accordance with section 705, *Modifications to the Opinion in the Independent Auditor’s Report*^{fn16}
- When section 701 applies, the matters planned to be included in the auditor’s report. ***Proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards, requires the engagement partner, prior to dating the auditor’s report, to review the financial statements and the auditor’s report, including, if applicable, the description of the key audit matters and related audit documentation, to determine that the report to be issued will be appropriate in the circumstances.***¹⁷

¹⁶ Paragraph .31 of section 705, *Modifications to the Opinion in the Independent Auditor’s Report*.

¹⁷ ***Paragraph 33 of proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.***

[Subsequent footnotes are renumbered.]

[No further amendment to AU-C section 260.]

5. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2023. This date is provisional but will not be earlier than December 15, 2023.

AU-C Section 300, *Planning an Audit*

Introduction

Scope of This Section

[No amendment to paragraph .01.]

~~The Role and Timing of Planning~~

.02 Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate *Quality management at the engagement level in accordance with proposed Statement on Auditing Standards (SAS) Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards, in conjunction with adequate planning in accordance with this section*, benefits the audit of financial statements in several ways, including the following:

- Helping the auditor identify and devote appropriate attention to important areas of the audit

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- Helping the auditor identify and resolve potential problems on a timely basis
- Helping the auditor properly organize and manage the audit engagement so that it is performed in an effective and efficient manner
- Assisting in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks and allocating team member responsibilities
- Facilitating the direction and supervision of engagement team members and the review of their work
- Assisting, when applicable, in coordination of work done by auditors of components and specialists

[No amendment to paragraphs .03–.05.]

Preliminary Engagement Activities

.06 The auditor should undertake the following activities at the beginning of the current audit engagement:

- a. Performing procedures required by ~~section 220~~, ***proposed SAS Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*** regarding the ***acceptance and*** continuance of the client relationship and the ~~specific~~ audit engagement;
- b. Evaluating compliance with relevant ethical requirements in accordance with ~~section 220~~, ***proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards***
- c. Establishing an understanding of the terms of the engagement, as required by section 210, *Terms of Engagement*: (Ref: par. .A6–.A8)

[No amendment to paragraph .07.]

Planning Activities

.08 In establishing the overall audit strategy, the auditor should ***consider the information obtained from complying with the requirements of proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards and***

- a. identify the characteristics of the engagement that define its scope;
- b. ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required;
- c. consider the factors that, in the auditor’s professional judgment, are significant in directing the engagement team’s efforts;

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- d. consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and
- e. ascertain the nature, timing, and extent of resources necessary to perform the engagement. (Ref: par. A9–A13)

.09 The auditor should develop an audit plan that includes a description of the following:

- a. ***The nature, timing, and extent of the planned direction and supervision of engagement team members and the review of their work.*** (Ref: par. ~~A18–A19~~.A14–.A15)
- b. ~~a.~~ The nature and extent of planned risk assessment procedures, as determined under section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*
- c. ~~b.~~ The nature, timing, and extent of planned further audit procedures at the relevant assertion level, as determined under section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*
- d. ~~e.~~ Other planned audit procedures that are required to be carried out so that the engagement complies with generally accepted auditing standards (Ref: par. ~~A14–A16~~–.A18)

[No amendment to paragraph .10.]

.11 The auditor ***engagement partner*** should ~~plan the nature, timing, and extent of direction and supervision of engagement team members and the review of their work~~ ***review the overall audit strategy and audit plan.*** (Ref: par. ~~A18–A19~~)

[No amendment to paragraphs .12–.13.]

Documentation

- .14** The auditor should include in the audit documentation the following:^{fn 3}
- a. The overall audit strategy
 - b. The audit plan
 - c. Any significant changes made during the audit engagement to the overall audit strategy or the audit plan, ***including any significant changes to the nature, timing, and extent of the planned direction and supervision of engagement team members and the review of their work,***^{fn 4} and the reasons for such changes. (Ref: par. .A23–.A26)

^{fn 3} [Footnote omitted for purposes of this exposure draft.]

^{fn 4} ***Paragraphs 30 and A92–A93 of proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.***

Application and Other Explanatory Material

.A1 *Proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards addresses the specific responsibilities of the auditor regarding quality management at the engagement level for an audit of financial statements and the related responsibilities of the engagement partner. Information obtained from complying with the requirements of proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards is relevant to this section. For example, in accordance with proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards, the engagement partner is required to determine that sufficient and appropriate resources to perform the engagement have been assigned or made available to the engagement team, taking into account the nature and circumstances of the audit engagement. Such a determination is directly relevant when ascertaining the nature, timing, and extent of resources necessary to perform the engagement in the overall strategy, as required by paragraph .08 of this section.*

The Role and Timing of Planning (Ref: par. .01)

~~A1~~**A2** The nature and extent of planning activities will vary according to the size and complexity of the entity, the key engagement team members' previous experience with the entity, and changes in circumstances that occur during the audit engagement. *In planning the audit, the auditor may use project management techniques and tools. Proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards^{fn 5} describes how such techniques and tools may support the engagement team in managing the quality of the engagement.*

^{fn 5} *Paragraphs A73–A74 of proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.*

[Subsequent footnotes are renumbered.]

[No amendment to paragraph .A2, renumbered as paragraph .A3.]

~~A3~~**A4** The auditor may decide to discuss elements of planning with the entity's management to facilitate the conduct and management of the audit *help the auditor manage and achieve quality at the engagement level* (for example, to coordinate some of the planned audit procedures with the work of the entity's personnel). Although these discussions often occur, the overall audit strategy and the audit plan remain the auditor's responsibility. When discussing matters included in the overall audit strategy or audit plan, care is required in order not to compromise the effectiveness of the audit. For example, discussing the nature and timing of detailed audit procedures with management may compromise the effectiveness of the audit by making the audit procedures too predictable.

[No amendment to paragraphs .A4–.A5, renumbered as paragraphs .A5–.A6.]

Preliminary Engagement Activities (Ref: par. .06)

.A67 Performing the preliminary engagement activities, which are specified in paragraph .06, at the beginning of the current audit engagement assists the auditor in identifying and evaluating

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events or circumstances that may adversely affect the auditor's ability to ~~plan and perform the audit engagement~~ **manage and achieve quality at the engagement level in accordance with proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.**

~~.A7A8~~ Performing these preliminary engagement activities enables the auditor to plan an audit engagement for which ~~to~~, for example

- ~~the auditor maintains~~ **maintain** the necessary independence and ability to perform the engagement.
- **determine that** the auditor has no issues with management integrity that may affect the auditor's willingness to continue the engagement.
- **determine that there is** ~~the auditor has~~ no misunderstanding **between the auditor and** ~~with~~ the entity about the terms of the engagement.

~~.A8A9~~ The auditor's consideration of client continuance and relevant ethical requirements, including independence, occurs throughout the audit engagement as conditions and changes in circumstances occur. Performing initial procedures on both client continuance and evaluation of relevant ethical requirements (including independence) at the beginning of the current audit engagement means that they are completed prior to the performance of other significant activities for the current audit engagement. For continuing audit engagements, such initial procedures often begin shortly after (or in connection with) the completion of the previous audit.

Planning Activities

The Overall Audit Strategy (Ref: par. .07-.08)

~~.A9A10~~ The process of establishing the overall audit strategy ~~assists the auditor to determine~~, subject to the completion of the auditor's risk assessment procedures, **may include** such matters as the following:

- The **nature of** resources (**human, technological, or intellectual**) to ~~deploy~~ **be deployed** for specific audit areas, ~~such as for example, the use~~ **deployment** of appropriately experienced team members for high risk areas or the ~~involvement~~ **assignment** of specialists ~~on~~ **to address** complex matters
- The amount of resources to ~~allocate~~ **be allocated** to specific audit areas, ~~such as for example, the number of team members assigned to observe~~ **attend** the **physical** inventory count at ~~material~~ **multiple** locations, the extent of review of component auditors' work in the case of group audits, or the audit budget (in hours) to allocate to high risk areas
- When these resources are to be deployed, such as whether at an interim audit stage or at key cut-off dates
- How such resources are ~~managed, directed, and supervised, such as or used, for example, when team briefing and debriefing meetings are expected to be held, how the engagement partner and manager reviews are expected to take place (for example, on site or off site), and whether to complete engagement quality control reviews~~

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.A11 Proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards contains requirements and guidance on engagement resources and engagement performance (including direction and supervision of the members of the engagement team and the review of their work).

[No amendment to paragraphs .A10–.A17, renumbered as paragraphs .A12–.A19.]

Direction, Supervision, and Review (Ref: par. .11)

.A18A20 Proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards addresses the engagement partner’s responsibility for the The nature, timing, and extent of the direction and supervision of engagement team members and review of their work. ^{fn 10} ~~vary, depending on many factors, including the following:~~

- ~~• The size and complexity of the entity~~
- ~~• The area of the audit~~
- ~~• The assessed risks of material misstatement (for example, an increase in the assessed risk of material misstatement for a given area of the audit ordinarily requires a corresponding increase in the extent and timeliness of direction and supervision of engagement team members and a more detailed review of their work)~~
- ~~• The capabilities and competence of the individual team members performing the audit work~~

~~Section 220 contains further guidance on the direction, supervision, and review of audit work.~~

^{fn 10} ***Paragraphs 29–31 of proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.***

[Subsequent footnotes are renumbered.]

Considerations Specific to Smaller, Less-Complex Entities Scalability

.A19A21 If an audit is carried out entirely by the engagement partner, questions of direction and supervision of engagement team members and review of their work do not arise. In such cases, the engagement partner, having personally conducted all aspects of the work, will be aware of all material issues. Forming an objective view on the appropriateness of the judgments made in the course of the audit can present practical problems when the same individual also performs the entire audit. If particularly complex or unusual issues are involved, and the audit is performed by a sole practitioner, it may be desirable to consult with other suitably experienced auditors or the auditor’s professional body.

[No amendment to paragraphs .A20–.A21, renumbered as paragraphs .A22–.A23.]

Additional Considerations in Initial Audit Engagements (Ref: par. .13)

.A22A24 The purpose and objective of planning the audit are the same whether the audit is an initial or recurring engagement. However, for an initial audit, the auditor may need to expand the planning activities because the auditor does not ordinarily have the previous experience with the entity that is considered when planning recurring engagements. For an initial audit

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engagement, additional matters the auditor may consider in establishing the overall audit strategy and audit plan include the following:

- Arrangements to be made with the predecessor auditor (for example, to review the predecessor auditor's working papers [see section 510, *Opening Balances — Initial Audit Engagements, Including Reaudit Engagements*])^{fn 8}
- Any major issues (including the application of accounting principles or auditing and reporting standards) discussed with management in connection with the initial selection as auditor, the communication of these matters to those charged with governance, and how these matters affect the overall audit strategy and audit plan
- The audit procedures necessary to obtain sufficient appropriate audit evidence regarding opening balances (see section 510)^{fn 9}
- Other ~~procedures required~~ **responses designed and implemented** by the ~~firm's~~ **firm's** system of quality control ~~firm~~ for initial audit engagements (for example, the firm's system of quality control ~~control~~ **management** may **include responses that** require ~~the involvement of another partner or senior individual~~ **with appropriate authority** to review the overall audit strategy prior to commencing significant audit procedures or to review reports prior to their issuance)

^{fn 8-9} [Footnotes renumbered as 11 and 12, and omitted for purposes of this exposure draft.]

Documentation (Ref: par. .14)

~~.A23.~~**A25** The documentation of the overall audit strategy is a record of the key decisions considered necessary to properly plan the audit **in managing quality at the engagement level** and **a means to** communicate significant issues to the engagement team. For example, the auditor may summarize the overall audit strategy in the form of a memorandum that contains key decisions regarding the overall scope, timing, and conduct of the audit.

.A26 *Documentation of the direction and supervision of engagement team members and the review of their work in accordance with proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards may also provide a record of significant changes to the planned nature, timing, and extent of the direction, supervision, and review.*

[No amendment to paragraphs .A24–.A26, renumbered as paragraphs .A27–.A29.]

~~Appendix — Considerations in Establishing the Overall Audit Strategy~~ *Managing Quality at the Engagement Level* (Ref: par. .07–.08 and .A9–.A12)

~~.A27.~~**A30**

This appendix provides examples of matters the auditor may consider in ~~establishing the overall audit strategy~~ **managing quality at the engagement level**. Many of these matters also will influence the auditor's **overall audit strategy and** detailed audit plan. The examples provided cover a broad range of matters applicable to many engagements. Although some of the following matters may be required by other AU-C sections, not all matters are relevant to every audit engagement, and the list is not necessarily complete.

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Nature, Timing, and Extent of Resources

The following examples illustrate the nature, timing, and extent of resources:

- The ~~selection~~ **human, technological, and intellectual resources assigned or made available to the engagement (for example, assignment of the engagement team (including, when necessary, the engagement quality control reviewer [see section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*]) and the assignment of audit work to the team members, including the assignment of appropriately experienced team members to areas in which there may be higher risks of material misstatement**
- Engagement budgeting, including considering the appropriate amount of time to set aside for areas in which there may be higher risks of material misstatement

[No further amendment to AU-C section 300.]

6. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2023. This date is provisional but will not be earlier than December 15, 2023.

AU-C Section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

Introduction

Scope of This Section

[No amendment to paragraphs .01–.04.]

.05 In accordance with ~~section 220~~, **proposed SAS Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards**, the group engagement partner is required to ~~be satisfied~~ **determine** that those performing the group audit engagement, including component auditors, collectively possess the appropriate competence and capabilities, **including sufficient time**.^{fn 1} The group engagement partner also is responsible for the direction ~~and~~; supervision **of members of the group engagement team**, and ~~performance of the group audit engagement~~ **review of their work**.^{fn 2} In this section, requirements to be undertaken by the group engagement partner are addressed to the group engagement partner. When the group engagement team may assist the group engagement partner in fulfilling a requirement, the requirement is addressed to the group engagement team. When it may be appropriate in the circumstances for the firm to fulfill a requirement, the requirement is addressed to the auditor of the group financial statements.

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^{fn 1} Paragraphs ~~425–26~~ of ~~section 220~~, **proposed Statement on Auditing Standards Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.**

^{fn 2} **Paragraphs 29–31 of proposed Statement on Auditing Standards Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.**

[Subsequent footnotes are renumbered.]

[No further amendment to AU-C section 600.]

7. This amendment is effective for audits of group financial statements for periods beginning on or after December 15, 2023. This date is provisional but will not be earlier than December 15, 2023.

AU-C Section 620, *Using the Work of an Auditor’s Specialist*

[No amendment to paragraphs .01–.07.]

.08 The nature, timing, and extent of the auditor’s procedures with respect to the requirements in paragraphs .09–.13 will vary depending on the circumstances. In determining the nature, timing, and extent of those procedures, the auditor should consider matters including (Ref: par. .A11)

- a. the nature of the matter to which the work of the auditor’s specialist relates;
- b. the risks of material misstatement in the matter to which the work of the auditor’s specialist relates;
- c. the significance of the work of the auditor’s specialist in the context of the audit;
- d. the auditor’s knowledge of, and experience with, previous work performed by the auditor’s specialist; and
- e. whether the auditor’s specialist is subject to the auditor’s firm’s **system of quality management control policies and procedures**. (Ref: par. .A12–.A14)

[No amendment to paragraphs .09–.A6.]

.A7 If the preparation of the financial statements involves the use of expertise in a field other than accounting, the auditor, who is skilled in accounting and auditing, may not possess the necessary expertise to audit those financial statements. The engagement partner is required by ~~section 220~~ **proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards** to ~~be satisfied~~ **determine** that the engagement team and any external auditor’s specialists who are not part of the engagement team, collectively, have the appropriate competence and capabilities, **including sufficient time**, to perform the audit engagement. ^{fn 6} Further, the auditor is required by section 300 to ascertain the

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nature, timing, and extent of resources necessary to perform the engagement.^{fn 7} The auditor's determination of whether to use the work of an auditor's specialist, and, if so, when and to what extent, assists the auditor in meeting these requirements. As the audit progresses or as circumstances change, the auditor may need to revise earlier decisions about using the work of an auditor's specialist.

^{fn 6} Paragraph ~~426~~ of ~~section 220~~ *proposed Statement on Auditing Standards Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

^{fn 7} [Footnote omitted for purposes of this exposure draft.]

[No amendment to paragraphs .A8–.A10.]

.A11 The following factors may suggest the need for different or more extensive procedures than would otherwise be the case:

- The work of the auditor's specialist relates to a significant finding or issue that involves subjective and complex judgments.
- The auditor has not previously used the work of the auditor's specialist and has no prior knowledge of that specialist's competence, capabilities, and objectivity.
- The auditor's specialist is performing procedures that are integral to the audit rather than being consulted to provide advice on an individual matter.
- The specialist is an auditor's external specialist and is not, therefore, subject to the firm's *system of quality management control policies and procedures*.

The Auditor's Firm's System of ~~Quality Control Policies and Procedures~~ Management (Ref: par. .08e)

.A12 An auditor's internal specialist may be a partner or staff, including temporary staff (*that is, personnel*), of the auditor's firm and, therefore, subject to the *system of quality control policies and procedures management* of that firm in accordance with QC section 10, *proposed Statement on Quality Management Standards A Firm's System of Quality Control Management*.^{fn 10} An auditor's internal specialist also may be a partner or staff, including temporary staff, of a network firm, *and is subject to the firm's policies or procedures for network requirements and network services in accordance with proposed Statement on Quality Management Standards A Firm's System of Quality Management. In some instances, the auditor's internal specialist of a network firm may be subject to which may share common quality control management policies and or procedures with as the auditor's firm, given that they are part of the same network.*

^{fn 10} Paragraph ~~437~~ of *proposed Statement on Quality Management Standards, A Firm's System of Quality Management*.

.A13 ~~In accordance with~~ *As described in section 220 proposed SAS Quality Management*

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for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards, *quality management at the* engagement teams are entitled to rely on the firm's system of quality control unless the engagement partner determines that it is inappropriate to do so based on information provided by the firm or other parties.^{fn11} The extent of that reliance will vary with the circumstances and may affect the nature, timing, and extent of the auditor's *level is supported by the firm's system of quality management and informed by the specific nature and circumstances of the audit engagement.*^{fn12} For example, the auditor may be able to depend on the firm's related policies or procedures with respect to such matters as the following:

- Competence and capabilities through recruitment and training programs.
- Objectivity. The auditor's internal specialists are subject to relevant ethical requirements, including those ~~pertaining~~ **relating** to independence.
- Agreement with the auditor's specialist.
- The auditor's evaluation of the adequacy of the work of the auditor's specialist. For example, the firm's training programs may provide the auditor's internal specialists with an appropriate understanding of the interrelationship of their expertise with the audit process. Reliance on such training ~~and other firm processes, such as protocols for scoping the work of the auditor's internal specialists,~~ may affect the nature, timing, and extent of the auditor's procedures to evaluate the adequacy of the work of the auditor's specialist.
- Adherence to regulatory and legal requirements through monitoring processes.

~~Such reliance~~ ***Matters that the auditor may take into account when determining whether to depend on the firm's policies or procedures are described in proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.***^{fn13} ***Depending on the firm's policies or procedures*** does not reduce the auditor's responsibility to meet the requirements of this section.

^{fn11} ~~Paragraph .05 of section 220.~~

^{fn12} ***Paragraph A4 of proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.***

^{fn13} ***Paragraphs 04b and A10 of proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.***

.A14 Proposed Statement on Quality Management Standards A Firm's System of Quality Management requires the firm to address the use of resources from a service provider, which includes the use of an external specialist. ^{fn14} An auditor's external specialist is not a member of the engagement team and is not subject to ~~quality control policies and procedures in accordance with QC section 10~~ ***the firm's policies or procedures under its system of quality management.*** ^{fn15} ***Furthermore, the firm's policies or procedures for relevant ethical requirements may include policies or procedures that apply to the auditor's external specialist.***

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fn 12 16

fn 14 Paragraph 33 of proposed Statement on Quality Management Standards A Firm's System of Quality Management.

fn 15 Paragraph 17 of proposed Statement on Quality Management Standards A Firm's System of Quality Management.

fn 12 16 Paragraph 1330b of QC section 10 proposed Statement on Quality Management Standards A Firm's System of Quality Management.

[Subsequent footnotes are renumbered.]

[No proposed amendment to paragraph .A15.]

.A16 Information regarding the competence, capabilities, and objectivity of an auditor's specialist may come from a variety of sources, such as the following:

- Personal experience with previous work of that specialist
- Discussions with that specialist
- Discussions with other auditors or others who are familiar with that specialist's work
- Knowledge of that specialist's qualifications, membership in a professional body or industry association, license to practice, or other forms of external recognition
- Published papers or books written by that specialist
- The *system of quality management* control policies and procedures of the auditor's firm and such other procedures the auditor considers necessary in the circumstances (see paragraphs .A12–.A13).

[No amendment to paragraphs .A17–.A28.]

.A29 When no written agreement exists between the auditor and the auditor's specialist, evidence of the agreement may be included in, for example

- planning memoranda or related working papers, such as the audit program.
- the policies ~~and or~~ procedures of the auditor's firm's *system of quality management*. In the case of an auditor's internal specialist, the ~~established policies and procedures to which the auditor's specialist is subject~~ *firm's system of quality management* may include particular policies ~~and or~~ procedures regarding the work of the auditor's specialist. The extent of documentation in the auditor's working papers depends on the nature of such policies ~~and or~~ procedures. For example, no documentation may be required in the auditor's

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working papers if the auditor's firm has detailed protocols covering the circumstances in which the work of such an auditor's specialist is used.

[No further amendment to AU-C section 620.]

8. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2023. This date is provisional but will not be earlier than December 15, 2023.

AU-C section 930, *Interim Financial Information*

[No amendment to paragraphs .01–.A59.]

.A60 When an engagement quality ~~control~~ review is performed, ~~section 220,~~ ***proposed Statement on Auditing Standards Quality Control Management*** for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards, requires that the ***engagement partner not date the auditor's report not be released prior to until*** the completion of the engagement quality ~~control~~ review.^{fn 27}

^{fn 27} Paragraph ~~2136d~~ of ~~section 220~~ ***proposed SAS Quality Control Management*** for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.

[No further amendment to AU-C section 930.]

9. This amendment is effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2023. This date is provisional but will not be earlier than December 15, 2023.

Amendment to SAS No. 130, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements, as Amended*

(Boldface italics denotes new language. Deleted text is in strikethrough.)

AU-C Section 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*

[No amendment to paragraphs .01–.A116.]

.A117 ~~Section 220,~~ ***Proposed Statement on Auditing Standards Quality Control Management*** for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards, requires that, on or before the date of the auditor's report, the engagement partner ***determine***, through a review of the audit documentation and discussion with the engagement

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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.^{fn 25} When an engagement quality control review is performed, ~~section 220~~ **proposed Statement on Auditing Standards Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards** requires that the *engagement partner not date the auditor's report not be released prior to* **until** the completion of the engagement quality control review.^{fn 26}

^{fn 25} ~~See paragraph Paragraph 432 of section 220, proposed SAS Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards, for further discussion.~~

^{fn 26} Paragraph 2436d of ~~section 220~~ **proposed SAS Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.**

[No further amendment to AU-C section 940.]

10. This amendment is effective for integrated audits for periods beginning on or after December 15, 2023. This date is provisional but will not be earlier than December 15, 2023.

Amendments to Various Sections in SAS No. 134, Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements, as Amended

(***Boldface italics*** denotes new language. Deleted text is in ~~strikethrough~~.)

AU-C Section 700, Forming an Opinion and Reporting on Financial Statements

[No amendment to paragraphs .01–.A38.]

.A39 Relevant ethical requirements may exist in several different sources, such as ethical codes and additional rules and requirements within law and regulation. When independence and other relevant ethical requirements are contained in a limited number of sources, the auditor may choose to name the relevant sources (for example, the AICPA Code of Professional Conduct, when applicable; the rule or applicable regulation; or *Government Auditing Standards* promulgated by the Comptroller General of the United States) or may refer to a term that appropriately describes those sources. Relevant ethical requirements, including those ~~pertain~~ **relating** to independence, in a group audit situation may be complex. Section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*,^{fn 21} provides guidance for auditors in performing work on the financial information of a component for a group audit, including those situations in which the component auditor does not meet the independence requirements that are relevant to the group audit.

^{fn 21} [Footnote omitted for purposes of this exposure draft.]

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[No amendment to paragraphs .A40–.A53.]

.A54 *Proposed SAS Section 220, Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, requires **the following with regard to dating the auditor’s report:**

- ~~that,~~ On or before the date of the auditor’s report, the engagement partner, through a review of the audit documentation and discussion with the engagement team, **is required to** be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor’s report to be issued. ^{fn 26}
- **Prior to dating the auditor’s report, the engagement partner is required to review the financial statements and the auditor’s report, including, if applicable, the description of the key audit matters and related audit documentation, to determine that the report to be issued will be appropriate in the circumstances.** ^{fn 27}
- When an engagement quality control review is performed, ~~section 220~~ the **engagement partner is precluded from dating the** auditor’s report ~~not be released prior to~~ **until** the completion of the engagement quality control review. ^{fn 278}

^{fn 26} See paragraph ~~Paragraph 432~~ of ~~section 220,~~ **proposed SAS Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards**, for further discussion.

^{fn 27} **Paragraph 33** of **proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards**.

^{fn 278} Paragraph ~~236d~~ of ~~section 220,~~ **proposed SAS Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards**.

[No further amendment to AU-C section 700.]

11. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2023. This date is provisional but will not be earlier than December 15, 2023.

AU-C Section 701, Communicating Key Audit Matters in the Independent Auditor’s Report

[No amendment to paragraphs .01–.A12.]

.A13 Certain AU-C sections, such as the following, require specific communications with those charged with governance and others that may relate to areas of significant auditor attention:

- a. Section 260, *The Auditor’s Communication With Those Charged With Governance*, requires the auditor to communicate significant difficulties, if any, encountered during the audit with those charged with governance. ^{fn 7} For example, there may be potential difficulties relating to the following:

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- i. *Related party transactions.* In particular, there may be limitations on the auditor's ability to obtain audit evidence that all other aspects of a related party transaction (other than price) are equivalent to those of a similar arm's-length transaction.^{fn 8}
- ii. *Limitations on the group audit.* For example, the group engagement team's access to information may be restricted.^{fn 9}

^{fn 7-9} [Footnotes omitted for purposes of this exposure draft.]

- b. ~~Section 220,~~ **Proposed Statement on Auditing Standards Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards**, establishes requirements for the engagement partner in relation to undertaking appropriate consultation on difficult or contentious matters **and matters on which the firm's policies or procedures require consultation and other matters that in the engagement partner's professional judgment, require consultation.**^{fn 10} For example, the auditor may have consulted with others within the firm or outside the firm on a significant technical matter, which may be an indicator that it is a key audit matter. The engagement partner is also required to discuss, among other things, significant matters **and significant judgments** arising during the audit engagement with the engagement quality ~~control~~ reviewer.

^{fn 10} Paragraph 2035 of ~~section 220,~~ **proposed SAS Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.**

[No amendment to paragraphs .A14–.A59.]

Communication With Those Charged With Governance (Ref: par. .16)

.A60 *Proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards, requires the engagement partner, prior to dating the auditor's report, to review the financial statements and the auditor's report, including, if applicable, the description of the key audit matters and related audit documentation, to determine that the report to be issued will be appropriate in the circumstances.*¹⁹

¹⁹ *Paragraph 33 of proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.*

[No amendment to paragraph .A60, renumbered as paragraph .A61.]

.A612 The requirement in paragraph .16b to communicate with those charged with governance when the auditor has determined that there are no key audit matters to communicate in the auditor's report may provide an opportunity for the auditor to have further discussion with others who are familiar with the audit and the significant matters that may have arisen (including the engagement quality ~~control~~ reviewer, when one has been appointed). These discussions may cause the auditor to reevaluate the auditor's determination that there are no key audit matters.

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[No amendment to paragraph .A62, renumbered as .A63.]

12. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2023. This date is provisional but will not be earlier than December 15, 2023.

Amendment to SAS No. 136, Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA, as Amended

(Boldface italics denotes new language. Deleted text is in strikethrough.)

AU-C Section 703, Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA

[No amendment to paragraphs .01–.A118.]

Date of the Auditor’s Report (Ref: par. .82 and .126)

A119. Proposed SAS Section 220, Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards, requires the following with regard to dating the auditor’s report:

- ~~that,~~ On or before the date of the auditor’s report, the engagement partner, through a review of the audit documentation and discussion with the engagement team, ***is required to*** be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor’s report to be issued.^{fn44}
- ***Prior to dating the auditor’s report, the engagement partner is required to review the financial statements and the auditor’s report, including, if applicable, the description of the key audit matters and related audit documentation, to determine that the report to be issued will be appropriate in the circumstances.***^{fn 45}
- When an engagement quality control review is performed, ~~section 220~~ the ***engagement partner is precluded from dating the*** auditor’s report ~~not be released prior to~~ ***until*** the completion of the engagement quality control review.^{fn 4546}

^{fn 44} See paragraph ~~Paragraph 1932~~ of ~~section 220,~~ ***proposed SAS Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards,*** for further discussion.

^{fn 45} See paragraph ~~Paragraph 33~~ of ~~section 220,~~ ***proposed SAS Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards,*** for further discussion.

^{fn 4546} Paragraph ~~2136d~~ of ~~section 220,~~ ***proposed SAS Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.***

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[No further amendment to AU-C section 703.]

13. This amendment is effective for audits of ERISA plan financial statements for periods beginning on or after December 15, 2023. This date is provisional but will not be earlier than December 15, 2023.

Amendment to SAS No. 137, The Auditor’s Responsibilities Relating to Other Information Included in Annual Reports, as Amended

(*Boldface italics* denotes new language. Deleted text is in ~~strikethrough~~.)

AU-C section 720, Other Information Included in Annual Reports

[No amendment to paragraphs .01–.A26.]

.A27 In accordance with ~~section 220,~~ ***proposed Statement on Auditing Standards Quality Control Management*** for an Engagement Performed in Accordance With Generally Accepted Auditing Standards,^{fn 8} the engagement partner is required to take responsibility for the direction, ~~and supervision, and performance of the audit engagement~~ ***of the members of the engagement team and the review of their work, and determine that the nature, timing, and extent of direction, supervision, and review is planned and performed*** in compliance with ***the firm’s policies or procedures***, professional standards, and applicable legal and regulatory requirements.^{fn 8} In the context of this section, factors that may be considered when determining the appropriate engagement team members to address the requirements of paragraphs .16–.17 of this section include the following:

- The relative experience of engagement team members
- Whether the engagement team members have the relevant knowledge obtained in the audit to identify inconsistencies between the other information and that knowledge
- The degree of judgment involved in addressing the requirements of paragraphs .16–.17 of this section, for example, performing procedures to evaluate the consistency of amounts in the other information that are intended to be the same as amounts in the financial statements may be carried out by less experienced engagement team members
- Whether, in the case of a group audit, it is necessary to make inquiries of a component auditor in addressing the other information related to that component

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^{fn 8} Paragraphs ~~17a.29–30~~ of section ~~220~~ *proposed SAS Quality Control Management for an Engagement Performed in Accordance With Generally Accepted Auditing Standards.*

[No further amendment to AU-C section 720.]

14. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2023. This date is provisional but will not be earlier than December 15, 2023.

Amendment to SAS No. 142, *Audit Evidence*

Appendix B — Amendments to Various Sections in Statement on Auditing Standards No. 122, *Statements on Auditing Standards: Clarification and Recodification*, as Amended

.A68

...

AU-C Section 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards

.A27 Unconscious or conscious auditor biases may affect the auditor’s professional skepticism and professional judgment, including, for example, in the design and performance of audit procedures or the evaluation of audit evidence. Examples of unconscious auditor biases are provided in paragraph A35 of proposed Statement on Auditing Standards *Quality Management of an Audit Conducted in Accordance With Generally Accepted Auditing Standards*. ~~that may impede the maintenance of professional skepticism and, therefore, the reasonableness of the professional judgments made by the auditor in complying with the requirements of this section, may include the following:~~

- ~~Availability bias, which is a tendency to place more weight on events or experiences that immediately come to mind or are readily available than on those that are not~~***
- ~~Confirmation bias, which is a tendency to place more weight on information that corroborates an existing belief than information that contradicts or casts doubt on that belief~~***
- ~~Overconfidence bias, which is a tendency to overestimate one's own ability to make accurate assessments of risk or other judgments or decisions~~***
- ~~Anchoring bias, which is a tendency to use an initial piece of information as an anchor against which subsequent information is inadequately assessed~~***

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- ~~Automation bias, which is a tendency to favor output generated from automated systems, even when human reasoning or contradictory information raises questions about whether such output is reliable or fit for purpose~~

[Paragraphs .A27–.A86 have been renumbered.]

15. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2023. This date is provisional but will not be earlier than December 15, 2023.

Amendment to Statement on Standards for Attestation Engagements No. 18, Attestation Standards: Clarification and Recodification, as Amended, Section 105, Concepts Common to All Attestation Engagements

(*Boldface italics* denotes new language. Deleted text is in ~~strikethrough~~.)

AT-C Section 105, Concepts Common to All Attestation Engagements

[No amendment to paragraphs .01–.05.]

Relationship of Attestation Standards to Quality Control Standards

.06 Quality ~~control~~ *management* systems, policies, and procedures are the responsibility of the firm in conducting its attestation practice. Under ~~QC section 10~~ *proposed Statement on Quality Management Standards A Firm’s System of Quality Control Management*, the firm has an obligation to ~~establish~~ *design, implement, and maintain* ~~operate~~ a system of quality ~~control~~ *management* to provide it with reasonable assurance that ^{fn5} (Ref: par. .A4–.A6)

- a. the firm and its personnel comply with professional standards and applicable legal and regulatory requirements and
- b. practitioners’ reports issued by the firm are appropriate in the circumstances.

^{fn5} Paragraph ~~1220~~ of ~~QC section 10~~, *proposed Statement on Quality Management Standards A Firm’s System of Quality Control Management* (AICPA, *Professional Standards*).

.07 Attestation standards relate to the conduct of individual attestation engagements; quality ~~control~~ *management* standards relate to the conduct of a firm’s attestation practice as a whole. Thus, attestation standards and quality ~~control~~ *management* standards are related, and the quality ~~control~~ *management* policies and procedures that a firm adopts may affect both the conduct of individual attestation engagements and the conduct of a firm’s attestation practice as a whole. However, deficiencies in or instances of noncompliance with a firm’s quality ~~control~~ *management* policies and procedures do not, in and of themselves, indicate that a particular engagement was not performed in accordance with the attestation standards.

[No further amendment to AT-C section 105.]

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16. This amendment is effective for practitioners' reports dated on or after December 15, 2023. This date is provisional but will not be earlier than December 15, 2023.