

CA/DPSC&E/Circular-9/2008

September 19, 2008

ALL PRACTICING MEMBERS OF THE INSTITUTE

Dear Member,

SELF ASSESSMENT BY THE FIRMS TO DETERMINE THEIR ABILITY TO COMPLY WITH THE INTERNATIONAL STANDARD ON QUALITY CONTROL 1 (ISQC 1).

The Council of the Institute, on the recommendation of the Quality Assurance Board, in its 194th meeting held on January 22, 2008 decided to adopt the ISQC-1 which was communicated to members vide Circular No. CA/DPS&E/Circular-2/2008, dated February 6, 2008.

Compliance of ISQC-1 is **recommendatory** for all firms doing audit of listed and public interest entities from accounting periods beginning on or after 1 July 2008 and will become **mandatory** for all firms doing audit of listed and public interest entities from accounting periods beginning on or after 1 July 2009.

In the context of above, ICAP developed and circulated amongst the members a 'Self-Assessment Questionnaire' to assist them in assessing and demonstrating their compliance with ISQC-1. In this back-drop, a series of round table meetings were held at Karachi, Lahore and Islamabad to assist members in evaluating their resourcefulness and compatibility for compliance of ISQC-1.

A number of practicing members from firms of varied sizes and resources participated in the above referred meetings and discussed at length pros-and-cons of ISQC-1 adoption as well as its elements.

All the discussions held and feedback and comments received in the said meetings have been summarized and compiled in the form of Q&A, especially for study of those members who could not attend the said meetings. This compilation can serve as a valuable learning tool for engagement partners and other senior personnel of the firm(s). Copy of said compilation is attached herewith and is also available for download at <http://www.icap.org.pk/web/links/253/circulars.php>.

Should you require any clarification or assistance, please do not hesitate to contact the undersigned on phone 9251645 or at email address zash@icap.org.pk.

Thanking you.

Yours truly,

Zulfiqar Ali Sheikh
Senior Manager
Professional Standards Compliance & Evaluation

Encl. As above.

SUMMARY OF COMMENTS/ DISCUSSIONS DURING ROUNDTABLE MEETINGS

SELF ASSESSMENT BY THE FIRMS TO DETERMINE THEIR ABILITY TO COMPLY INTERNATIONAL STANDARD ON QUALITY CONTROL 1 (ISQC 1).

The Institute of Chartered Accountants of Pakistan (the Institute/ ICAP) has adopted the ISQC 1 "Quality Control for Firms that perform Audits and Reviews of Historical Financial Information and Other Assurance and Related Services Engagements".

Communication in this regard was made to all practicing members vide a Circular dated February 6, 2008. ISQC 1 will become mandatory for all audit firms conducting audit of listed and public interest entities from accounting periods beginning on or after July 1, 2009. Firms are, therefore, being encouraged to initiate the process of compliance with this Standard.

ISQC 1 is directed at how a firm organizes its practice rather than how the firm conducts individual audits. Compliance with ISQC 1 will enhance the overall quality controls and procedures implemented by the firms for performing audits and other assurance services.

In order to initiate the above compliance, ICAP has developed a questionnaire which is a tool for firms to assist them in assessing and demonstrating their compliance with ISQC 1. In this respect, the Institute held a series of roundtable meetings at Karachi, Lahore and Islamabad in the month of June 2008.

The main purpose of the roundtable meetings was to guide the members in completing the self assessment questionnaire and to determine their ISQC 1 compliance requirements.

Given below is the feedback based on the comments given and discussion held with the members during the roundtable meetings. This has been compiled in the form of questions/comments and responses given on them, classified under the headings of various elements of the quality control system specified in the Standard.

1. GENERAL/ INTRODUCTORY MATTERS

1. 1 Why ISQC 1 is being adopted by the Institute and being imposed on us? Are we really equipped to adopt it keeping in view of the fact that majority of the practicing firms are small sized (sole member firms or two or three partner firms)?

ICAP being a member of IFAC is obliged to adopt its pronouncements. ISQC 1 has been adopted by other countries' member bodies and we have already delayed it by three years (originally effective from June 2005) by making it only recommendatory from the next year (corresponding with accounting periods beginning on or after July 1, 2008) after which it will become compulsory from July 1, 2010 (corresponding with accounting periods beginning on or after July 1, 2009).

ISQC 1 actually focuses upon small and medium sized firms who are expected to realize and understand its requirement and equip themselves within their resources.

ICAP is committed to provide all possible help to the practicing members/SMPs in connection with their efforts in meeting the Standard's quality control requirements and its compliance.

1.2 Is ISQC 1 applicable for all engagements or audit engagements of listed and public interest entities?

First, it has to be clearly understood that ISQC 1 lays down quality control parameters for firms and not for individual audits. ISA 220 deals with QC issues for specific engagements.

Accordingly, ISQC 1 applies to all firms engaged in listed company and public interest entity audits. While this essentially means that the focus of QC systems to be devised and implemented will be with reference to listed and public interest entities, the systems compliance will be applicable on firm-wide basis which will automatically cover other engagements also as, logically, a firm will not have two parallel systems for quality control of different audit engagements.

1.3 ISQC 1 does not seem to be implementable by us in the near future considering our circumstances and resource constraints. Has ICAP considered how much time is required to implement it?

Keeping in view the circumstances and resource constraints of our small practicing firms the compulsory compliance has been deferred till July 2010 (as noted above).

ICAP has taken this initiative to start ISQC 1 mentoring and support program for SMPs so that they get sufficient time to obtain guidance, assess themselves and start developing their systems, gradually, in compliance with the Standard.

1.4 Size of the firm should be considered for applicability of ISQC 1. The requirements of the Standard should be made applicable according to difference in sizes of the firms.

As already explained, since ISQC 1 focuses on SMPs the limitations due to small size and meager resources is impliedly recognized. The requirements specified are minimal and the firms are expected to comply with them according to their resources, i.e., very small or single/two partner firms can comply by putting in place minimum acceptable documentation relating to the various quality control elements/areas defined in the Standard. Bigger firms can have more elaborate policies and procedures commensurate with their size and resources.

1.5 In case of sole practitioner firm and small partnerships pooling of resources may be a good solution for meeting ISQC 1 requirements. It was suggested that ICAP should take steps in helping firms to form small networks.

Considering the resource constraints and circumstances in which SMPs operate, pooling of resources is indeed a good idea for initiating and implementing ISQC 1 requirements. This will enable smaller firms to make an early start of the QC process without being further strained due to meager resources.

ICAP will be more than willing to help and provide all possible support to firms who approach it in connection with the already announced networking mechanism.

1.6 Instead of requiring the firms to fill and send the questionnaire ICAP should develop and send the manual of ISQC 1 to the firms.

The purpose of developing the questionnaire and sending it to firms, as has been explained during the roundtable meetings, was to enable firms in understanding the practical side of ISQC 1 and to self assess themselves in terms of their capacity/capability and general preparedness for complying with the Standard's requirement.

The manual is being prepared to provide firms with the standard QC system documentation based on ISQC 1 requirements, more as a guideline, following which the firms can develop/tailor their own systems and documentation.

1.7 ICAP should formulate and implement “licensing policy” for allowing firms to provide different types of services.

ICAP is considering to introduce two categories of licenses, one for assurance and all other similar work and the second for only non assurance services

2. LEADERSHIP RESPONSIBILITIES

2.1 With reference to the assigning of responsibilities, how should the sole member firm or a two partner firm deal with the requirement?

By including a “sole practitioner” in the definition of “firm” ISQC 1 clearly recognizes that the various responsibilities/roles specified for meeting quality control requirements can be assumed by one person. Such responsibility can also be delegated/given to different partners or to persons who are not partners but have sufficient/required knowledge, experience and authority to handle the responsibilities, e.g., managers/qualified assistants, etc.

Thus, the person responsible for firm-wide quality controls may not necessarily be the managing partner or CEO or chairman of the board of partners. The sole practitioner or partners can also form a group sort of arrangement which can be given the QC responsibility. In case of SMPs not having sufficient resources, the requirements can be met by inducting new partners or hiring qualified assistants or by utilizing external resources like joining a network.

However, the expectation would be that whoever is made responsible will assume responsibility for firm wide quality control systems implementation.

3. ETHICAL REQUIREMENTS

3.1 With reference to ethical requirements, it was suggested that “code of ethics” should be included in the course so that students are aware of the requirements.

Compliance with ethical requirements is reflected by the firms culture and approach and is inculcated through practices adopted by the firm’s leadership. Thus, all firms personnel from the partner(s) to professionals and support staff should be aware of the fundamental principles of code of ethics and follow them consciously with motivation from the top.

It was noted that “code of ethics” was already part of the course for students. It can also be included as part of the training course for SMPs.

4. ACCEPTANCE AND CONTINUANCE OF CLIENT RELATIONSHIP

4.1 Procedures/documentation with reference to “acceptance” of a proposed client seems too much as obtaining knowledge about the background of management and seeking restricted information to assess their credentials and integrity does not sound practically possible. It is like conducting an investigation.

The requirement has to be understood and appreciated properly as initial “acceptance” of an audit engagement and its “continuance” evaluation in future years is very important from quality control perspective.

Basic information about the company, its sponsors/board of directors, market reputation, etc. can be easily obtained from various sources for meeting the minimum requirement. based on initial information, if any risks are identified or a need is felt to obtain further information to mitigate the risks and to achieve desired comfort level. The same should be obtained and assessed.

Obtaining certain restricted information about sponsors for establishing their integrity and credentials should not be seen as an investigation rather it is the due diligence required to be carried out in the normal course of prospective client's risk assessment for achieving the desired comfort level before accepting an engagement.

4.2 A view was given that it seems as if it is being discouraged to accept a client unless complete information and business credentials are obtained which may not be possible for all firms. It was commented that no standard requires declining acceptance of any engagement and any possible risks should be mitigated or minimized by adopting appropriate measures. It was further commented that in normal course acceptance should be given without performing any due diligence and if any problems are found these can be dealt by issuing "qualified" report.

It has to be understood that the objective of evaluating a prospective audit client is for assessing any risks to which the auditor may be exposed and to guard against these risks, if any.

It is basically for the auditor's benefit to have this pre-engagement comfort and then accept the audit. It would be incorrect to perceive this requirement as a measure of discouraging the acceptance of new engagements or for declining audit engagements. As explained, all the essential information is generally available based on which the auditor can evaluate and decide whether an audit client is acceptable or not in the normal course of business.

The comment/suggestion that all engagements should be accepted and any problems or risks identified/faced later be dealt with by issuing "qualified" report seems totally misplaced. Acceptance or continuance evaluation is essentially a pre-engagement requirement whereas auditors opinion is issued on the culmination of the engagement through which the conclusions of audit are reported.

5. HUMAN RESOURCE

5.1 Implementing quality control of engagements on firm-wide basis would be difficult due to insufficient HR resources available with small firms. Moreover, since majority of students are hired by bigger firms small firms are left with only low quality staff.

As noted earlier, HR resources will have to be developed if found insufficient/incapable in meeting the Standard's minimal requirements.

It should be understood that students are now much more conscious and demanding and obtain information about firms and evaluate them in their own way. The firms, whether small or big, will have to introduce and nurture a professional culture focusing on quality for attracting good students. Developing networks and pooling/sharing of resources by SMPs may be considered as a solution to the HR problems being faced.

6. ENGAGEMENT PERFORMANCE

6.1 ISQC 1 allows use of external resources like hiring external reviewers. However, with external reviewers conflict of interest or legal issue of confidentiality can arise. In order to overcome these ICAP should create a “pool of reviewers”.

Since the Standard allows hiring of external reviewers and utilization of external resources the issues associated are appreciated and can be addressed and resolved. The issue of “conflict of interest’ can be resolved through networking or similar formalized arrangements. Similarly, “confidentiality” issue can also be addressed by obtaining legal cover/amendments to the existing provisions.

ICAP can consider nominating focal persons who can be contacted by the firms to get their issues resolved, if possible.

6.2 How differences of opinion between the engagement partner and reviewer would be resolved? Who will be regarded as ultimately responsible?

In case of difference of opinion the firms can devise their own internal system like referring the matter to a technical committee or senior partner/CEO. In case of very small firms the matter can be referred to ICAP and based on the advice the issue can be resolved.

In any case, it has to be understood and appreciated that the ultimate responsibility of the engagement and opinion expressed lies with the engagement partner who can finally decide on a contentious issue. However, in case of bigger firms, senior partner/CEO or chairman of the board/technical committee may enjoy the authority to prevail upon the engagement partner in case of difference of opinion in which case the engagement partner’s responsibility will also be shared by the authority prevailing upon him/her.

6.3 A view was expressed that considering review requirements it will not be possible for a sole practitioner (single partner firm) to audit listed company accounts. It was commented that a minimum number of partners be decided for firms to be eligible for conducting listed company or public interest entity audits. It was further suggested that working environment for adoption of ISQC 1 be created first before its adoption.

It is certainly worth appreciating that in case of listed company audits the quality control requirements demand sufficient resources which may not be available with a sole practitioner. However, since ISQC 1 recognizes a sole practitioner, he/she is being considered eligible to audit a listed company provided the QC requirements in general and review requirement in particular are complied with either through external resources or other arrangements.

Creating working environment for adoption of ISQC 1 is indeed important for which firms have to make serious efforts. ICAP is committed to providing the necessary help and support to the firms and would be more than willing to respond to individual requests from firms for addressing any issues/problems they may identify in implementing the ISQC 1.

6.4 As part of internal resources can firms use ICAPs TAC for consultation on difficult or contentious matters? Such a practice is being done in USA.

Strictly speaking, ICAPs TAC cannot be considered a firm’s internal resource in the context in which it is mentioned in ISQC 1. However, contentious matters and issues requiring clarification can be referred to TAC by firms who wish to augment their internal consultation process in such situations. What exactly is the practice in USA in this regard will have to be checked/confirmed.

7. MONITORING

7.1 Most of the firms do not have any policy/procedure for receiving/dealing with complaints against partners or the firm. Is “whistle blowing” actually practiced?

Yes, this seems to be true that most of the firms, specially SMPs, who do not have formalized policy/procedures for handling client complaints. However, bigger firms already have prescribed systems in this regard. For SMPs, catering to this requirement is not all that difficult and would probably require initiating or formalizing the policy/procedures in this respect.

“Whistle blowing” is certainly rare and almost non-existent in our environment. While instances may exist in bigger firms it is still not in practice due to our local culture and prevailing environment.

BASED ON SUGGESTIONS/DISCUSSION FOLLOWING CHANGES WERE ACCEPTED TO BE MADE IN THE QUESTIONNAIRE:

In section 1.6.1” is the audit manual (i) commercially available” is being replaced by “is the audit manual (i) publicly available ...”

In section 1.7.16 “..... a person whose name has been removed from the register of members” the words “on disciplinary grounds” be added after the word “removed”.

The “declaration” given at the end of the questionnaire may be ignored.