



G A O

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Comptroller General
of the United States

United States Government Accountability Office
Washington, DC 20548

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International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, New York 10017

Subject: International Auditing and Assurance Standards Board (IAASB) July 2007
Exposure Drafts:

- *ISA 220, Quality Control for an Audit of Financial Statements*
- *ISQC 1, Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

GAO commends the International Auditing and Assurance Standards Board's efforts to clarify the quality control standards and guidance and thereby enhance the quality of auditors' work. We believe that an audit organization's quality control system is a fundamental and critical determinant of audit quality.

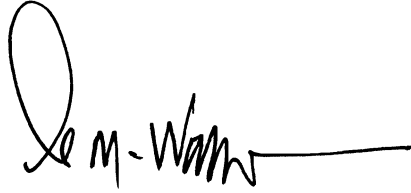
Overall, we support the approach taken in these proposed standards. We also agree with IAASB's decision to redraft ISQC 1 in conjunction with ISA 220 since both standards address important quality control considerations--ISQC 1 at the firm level and ISA 220 at the engagement level.

In our review of these proposed standards, we identified certain issues that, in our opinion, would benefit from additional clarification or better descriptive terminology. These issues, which are discussed in the attachment to this letter, focus on the following areas:

- Monitoring policies and procedures for smaller practices
- Engagement quality control reviews
- Independence considerations specific to public sector entities
- Definition of the term "network"
- Other suggestions

We thank you for considering our comments on these important issues.

Sincerely yours,

A handwritten signature in black ink, appearing to read "D. M. Walker", with a long horizontal line extending to the right.

David M. Walker
Comptroller General
of the United States

Attachment

cc: Mr. James M. Sylph, Technical Director
International Auditing and Assurance Standards Board

The Honorable Christopher Cox, Chairman
Securities and Exchange Commission

The Honorable Mark W. Olson, Chairman
Public Company Accounting Oversight Board

Mr. Harold Monk, Chair
Auditing Standards Board

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Monitoring Policies and Procedures for Smaller Practices

Considerations related to monitoring policies and procedures for smaller practices are discussed in Paragraph A64 of proposed ISQC 1. We are concerned that these small practice considerations are inconsistent with the requirements set forth in paragraph 55 of the proposed standard and are less robust than the provisions of paragraph 80 of extant ISQC 1. For instance, the first sentence of paragraph A64 suggests that in small audit organizations, it may be acceptable for monitoring procedures to be performed by individuals who also perform engagement quality control reviews. This appears contrary to paragraph 55(c) which requires that firms establish quality control policies and procedures requiring that those who perform the engagement or the engagement quality control review are not involved in inspecting the engagements.

While we recognize the importance of allowing flexibility for small audit organizations with limited resources, we also strongly believe it is important to emphasize that auditors are not permitted to monitor their own work. Therefore, to provide clear and appropriate guidance on this issue, we recommend revising paragraph A64 as follows:

Proposed ISQC 1, Paragraph A64: 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.~~ However, it would not be appropriate for individuals performing monitoring procedures to monitor their own work. For instance, it would not be appropriate for an individual to monitor the engagement quality control reviews that he or she performed. 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.

Engagement Quality Control Reviews

1. Paragraphs 19-23 and A16-A21 of proposed ISA 220 discuss how engagement quality control reviews are conducted but provide no guidance on when these reviews should be performed. Instead this guidance is detailed in proposed ISQC 1. In order to better integrate the two standards, we recommend including in proposed ISA 220, paragraph 19, a reference to the requirements and guidance related to engagement quality control reviews in paragraphs 41-49 and A37-A 47 of ISQC 1.

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Engagement Quality Control Reviews (cont)

2. We believe that ISA 220 would be improved by removing the references to listed companies from paragraphs 19 and A20. Since ISQC 1, paragraph 41, states that firm policies and procedures shall require engagement quality control reviews for financial statement audits of listed companies, it would be sufficient to refer to firm quality control policies and procedures in paragraphs 19 and A20 in ISA 220. Doing so would help streamline the proposed ISA and could replace vague wording such as “those other audit engagements for which an engagement quality control review is performed.”

In addition, we believe that ISA 220, paragraph A20, should be revised to more clearly explain public sector entity considerations that might make engagement quality control reviews appropriate for audits of these entities.

To implement the above changes, we recommend revising ISA 220, paragraphs 19 and A20, as follows:

Paragraph 19: For financial statement audits that are subject to engagement quality control review in accordance with firm quality control policies and procedures as required by ISQC 1, ~~For audits of financial statement of listed entities, and those other audit engagements for which an engagement quality control review is performed~~, the engagement partner shall:

- (a) Determine that an engagement quality control reviewer has been appointed;
- (b) Discuss significant matters arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer; and
- (c) Not date the auditor’s report until the completion of the engagement quality control review.

Paragraph A20: [Considerations Specific to Public Sector Entities] Financial statement audits of certain public sector entities may meet criteria that would subject them to engagement quality control review in accordance with firm quality control policies and procedures as required by ISQC 1. Examples could include audits of state owned corporations and public utilities. Because ongoing transformations within the public sector may give rise to new types of entities, periodic evaluation is important to determine which audits of public sector entities may meet criteria to warrant performance of an engagement quality control review. ~~Listed entities are not common in the public sector. However, there may be other public sector entities that are significant due to size, complexity or public~~

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Engagement Quality Control Reviews (cont)

~~interest aspects, and which consequently have a wide range of stakeholders. Examples include state owned corporations and public utilities. Ongoing transformations within the public sector may also give rise to new types of significant entities. There are no fixed objective criteria on which the determination of significance is based. Nonetheless, public sector auditors evaluate which entities may be of sufficient~~

3. Both paragraph 45 of ISQC 1 and paragraph 22 of ISA 220 discuss engagement quality control review requirements for audits of listed entities. These requirements, which include matters such as considering the engagement team's evaluation of the firm's independence in relation to the specific engagement, are essential elements of all engagement quality control reviews; therefore, we recommend that the IAASB revise these paragraphs to delete the reference to listed entities. These changes would complement the revisions we proposed in item 2 above.

4. ISQC1, paragraph A44 lists potential requirements for engagement quality control reviewers that firms may include in their quality control policies and procedures. These potential reviewer requirements include important items, for instance, that the reviewer is not selected by the engagement partner, and that the reviewer does not otherwise participate in the engagement during the period of review. We believe these potential reviewer requirements are critical for ensuring reviewer objectivity and recommend elevating them from the application to the requirement section of the proposed standard and making them applicable to all engagements that are subject to engagement quality control reviews.

Independence Considerations Specific to Public Sector Entities

In ISQC 1, paragraphs A8-A10 provide guidance related to familiarity threats to auditor independence and suggest that rotating senior engagement personnel may be appropriate to mitigate such threat, especially for financial statement audits of listed entities. Paragraphs A11-A13 continue this discussion in the context of public sector audit organizations. While we agree with the overall guidance for public sector entities in paragraphs A11-A13, we recommend revising the wording of this guidance to avoid misinterpretation and to promote consistency of application.

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For instance, paragraph A13 discusses public sector entities that are considered “comparable to listed entities” but does not explain how these public sector entities may be comparable or provide criteria for determining such comparability. Therefore, we recommend revising paragraphs A12 and A13, as follows

Paragraph A12: Listed entities as referred to in paragraphs 29 and A10 are not common in the public sector. However, there may be other public sector entities that are significant due to size, complexity or public interest aspects, and which consequently have a wide range of stakeholders. Therefore, there may be instances when a firm determines, based on its quality control policies and procedures, that a public sector entity is significant for purposes of expanded quality control procedures.

Paragraph A13: In the public sector, legislation may establish the appointments and terms of office of the auditor with engagement partner responsibility. As a result, it may not be possible to comply strictly with the engagement partner rotation requirements envisaged for listed entities. Nonetheless, for public sector entities considered significant as discussed in paragraph A12 ~~comparable to listed entities~~, it may be in the public interest for public sector audit organizations to establish policies and procedures to promote compliance with the spirit of rotation of engagement partner responsibility.

Definition of the Term “Network”

We believe that the accountability profession should use definitions that are clear and consistent. This is especially important with the standards being translated into numerous languages. We believe the definition for the term “network,” included in ISA 220, paragraph 6(j) and ISQC1, paragraph 12(k), would be improved by clearly explaining the nature of these entities as follows:

Network –An association of audit entities that is established to
(i) encourage cooperation among the members, and
(ii) develop profit or cost-sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand name, or a significant part of professional resources.

Network—A larger structure:
(i) That is aimed at cooperation, and
(ii) That is clearly aimed at profit or cost-sharing or shares common ownership, control or management, common quality control policies

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~~and procedures, common business strategy, the use of a common brand name, or a significant part of professional resources.~~

Other Suggestions

ISQC 1, paragraph 18 states that firms shall encourage personnel to communicate views or concerns related to quality control matters. We suggest strengthening this requirement by indicating with whom staff should be encouraged to communicate such matters.

Requirements related to quality control policies and procedures related to leadership responsibilities are discussed in paragraph 20 of ISQC 1. We suggest including recruiting and hiring personnel in the matters to address in these policies and procedures.