

Practitioner Alert

CANADIAN STANDARDS ON QUALITY MANAGEMENT

MAY 2021

STANDARDS DISCUSSED

- Canadian Standard on Quality Management (CSQM) 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*
- CSQM 2, *Engagement Quality Reviews*
- Canadian Auditing Standard (CAS) 220, *Quality Management for an Audit of Financial Statements*.

An Overview of Quality Management at the Firm Level – for Practitioners Designing, Implementing, Operating and Evaluating a System of Quality Management for the First Time

This *Practitioner Alert (Alert)* is applicable to all firms, including sole practitioners who perform compilation engagements. This *Alert* is being issued to raise awareness about the new Canadian standards on quality management at the firm and engagement level, including engagement quality reviews.

What you need to know?

In January 2021, the Auditing and Assurance Standards Board (AASB) unanimously approved the suite of quality management standards.

CSQM 1 and CAS 220 replace:

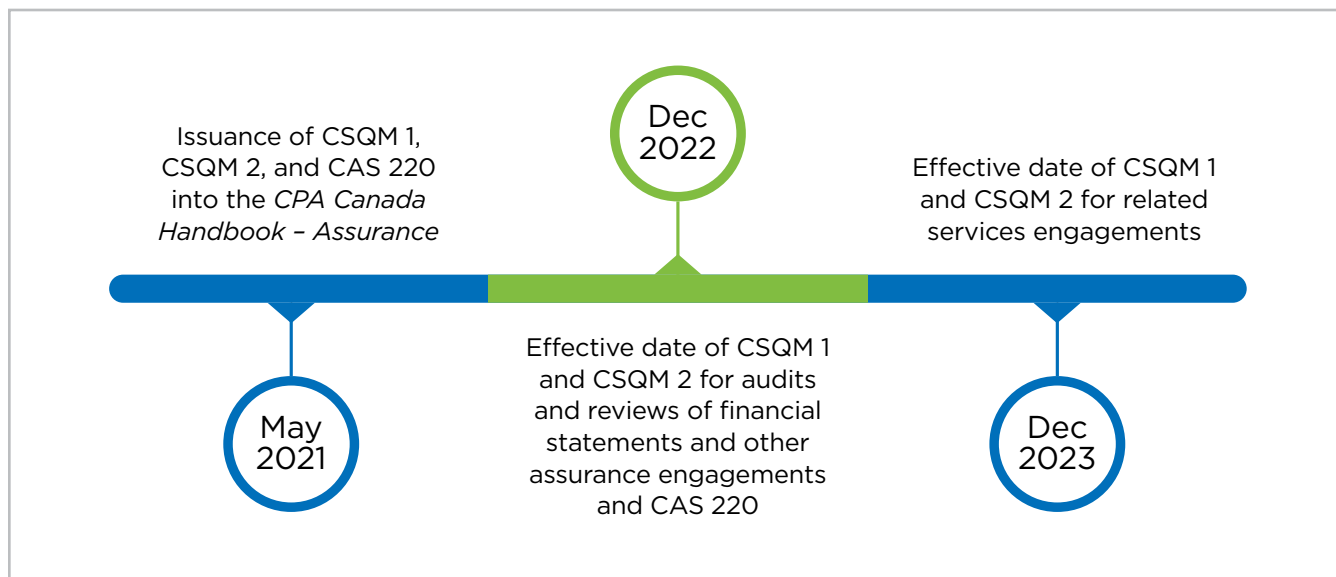
- Canadian Standard on Quality Control (CSQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial statements, and Other Assurance Engagements*
- CAS 220, *Quality Control for an Audit of Financial Statements*.

CSQM 2 is a new standard addressing the appointment and eligibility of engagement quality reviewers and their responsibilities when performing the engagement quality review (EQR).

This *Alert* provides detailed information on each of the three standards. It includes specific considerations for practitioners who may be designing, implementing, operating, and evaluating a system of quality management for the first time. Practitioners who already have quality control policies and procedures in place may also find the information useful for preparing their systems of quality management in accordance with CSQM 1.

This *Alert* does not address all aspects of [CSQM 1](#), [CSQM 2](#) and [CAS 220](#); practitioners should refer to the final standards in the *CPA Canada Handbook – Assurance (Handbook)* for a complete understanding of the requirements.

TIMELINE AND SEQUENCE OF EVENTS



Why should you read this *Alert*?

The new suite of quality management standards at the firm and engagement level brings a significant number of changes for Canadian practitioners performing *any* engagement addressed by standards in the *Handbook*.

CSQC 1 applied to audits and reviews of financial statements, as well as other assurance engagements and did not extend to related services engagements in the *Handbook*. Therefore, for many small and medium-sized practitioners (SMPs), including sole practitioners, who only perform compilation engagements, CSQC 1 did not apply. Under CSQM 1, these firms may be designing, implementing, and operating a system of quality management (SOQM), for the first time.

Who should read this *Alert*?

This *Alert* provides detailed information on the scope and effective date of CSQM 1. It also provides a high-level overview of the requirements of CSQM 1. CSQM 1 is applicable to all firms that perform audits or reviews of financial statements, or other assurance or related services engagements. Any firm that provides these services should read this *Alert*.

In particular, those firms that were not subject to CSQC 1, may find this *Alert* to be a useful introduction to the concept of managing quality.

CSQM 1

Do related services include all services I offer?

Related services refers to those services for which there are standards in the *Handbook*.

These include:

- Canadian Standard on Related Services (CSRS) 4200, *Compilation Engagements*
- CSRS 4400, *Agreed-Upon Procedures Engagements*
- CSRS 4460, *Reports on Supplementary Matters Arising from an Audit or a Review Engagement*
- other standards addressing association and consent

Related services do not include other services a practitioner may offer, including tax and consulting.

Why does the scope of CSQM 1 include related services engagements?

When the AASB issued its Exposure Draft on *Quality Management at the Firm and Engagement Level, Including Engagement Quality Reviews*, it proposed to adopt International Standard on Quality Management (ISQM) 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements* as CSQM 1. In doing so, the scope of the firm level quality management standard would be expanded to all engagements addressed by standards in the *Handbook*, including related services standards engagements. The AASB recognized that this would represent a significant change for many SMPs and sole practitioners who only

perform related services engagements. However, the AASB concluded that such a change would be appropriate for the following reasons:

- It is in the public interest that practitioners consistently perform high-quality engagements. A system of quality management will support the consistent performance of high-quality engagements.
- Related services engagements are being conducted for a broader range of external users. They are relevant and sought-after services. As a result, there is an increased need for quality management standards to drive the consistent performance of high-quality engagements.
- ISQM 1 is designed to be scalable to different firms, engagements, and subject matters now and in the future. It is intended to be scalable to the nature of the firm and the engagements it performs. As a result, the standard will facilitate the application of systems of quality management to smaller firms, including firms that only conduct related services engagements.

The International Auditing and Assurance Standards Board (IAASB) has prepared a [fact sheet](#) which provides an overview of ISQM 1 and quality management at the firm level.

The AASB conducted consultations during the Exposure Draft period with stakeholders, including SMPs and sole practitioners, to gather input on the proposals. The majority of stakeholders responding to the Exposure Draft and participants in various consultations agreed that quality management should extend to related services engagements and acknowledged that CSQM 1 is scalable and therefore easier to apply than CSQC 1.

When is CSQM 1 effective?

CSQM 1 has two different effective dates, based on the nature of the engagements.



Firms are required to design and implement their system of quality management for **audits and reviews of financial statements or other assurance engagements** by December 15, 2022. They are required to evaluate their system within one year following this date.



Firms are required to design and implement their system of quality management for **related services engagements** by December 15, 2023. They are required to evaluate their system within one year following this date.

Note: Timing of implementation is relative to the type of engagement performed.

Why is the effective date different for related services engagements?

Recognizing the significant effort that will be required by firms and practitioners who may be developing a system of quality management for the first time (i.e., those that were not required to follow CSQC 1), the AASB deferred the effective date by one year to December 15, 2023. The evaluation of the system of quality management required by CSQM 1 for related services engagements is required to be done within one year following this date.

What has changed between CSQC 1 and CSQM 1?

CSQM 1 moves away from a focus on quality control and introduces a new approach to managing quality that is best represented by a change in the name of the standards to “quality management.” The concept of quality control was thought to be reactive in nature, with many practitioners reviewing files after they were performed to ensure the requirements of quality control were met. Quality management, on the other hand, is intended to be proactive in nature, introducing a continuous process that is to be engrained in the firm’s culture and strategy.

What do I need to know as a first-time implementer?

If you have not applied CSQC 1 previously, CSQM 1 will be entirely new. It will be important to gain a full understanding of the standard, which includes examples to demonstrate how a system of quality management may be tailored to smaller or less complex firms. The following summarizes key aspects of CSQM 1, noting considerations specific to first-time implementers.

Objective of CSQM 1

The overall objective of CSQM 1 is for the firm to design, implement and operate a SOQM for audits or reviews of financial statements, or other assurance or related services engagements performed by the firm, 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
- engagement reports issued by the firm or engagement partners are appropriate in the circumstances.

Components of the SOQM

The SOQM under CSQM 1 has eight components:

1. firm’s risk assessment process
2. governance and leadership
3. relevant ethical requirements
4. acceptance and continuance of client relationships and specific engagements
5. engagement performance
6. resources
7. information and communication
8. monitoring and remediation process



The components operate in an iterative and integrated manner. Each component sets out quality objectives that are outcome-based and required to be established by the firm. Details of two processes are outlined in the respective sections below.

Assigning overall responsibilities

The firm is required to assign:

- ultimate responsibility and accountability for the SOQM to the firm's chief executive office or the firm's managing partner, or equivalent
- operational responsibility for the SOQM
- operational responsibility for specific aspects of the SOQM, including compliance with independence requirements, and the monitoring and remediation process

In a less complex firm, ultimate responsibility and accountability for the SOQM may be assigned to a single managing partner with sole responsibility for the oversight of the firm. The individual may also assume responsibility for all aspects of the SOQM, including operational responsibility for the SOQM, compliance with independence requirements and the monitoring and remediation process.

Risk assessment process

The risk-based approach to CSQM 1 is embedded throughout all the requirements in CSQM 1 and requires the firm to perform a risk assessment to identify quality risks and ground the response to the risks in policies or procedures. In performing the risk assessment, the firm is required to:

- establish quality objectives under each component of the SOQM (note that CSQM 1 sets out objectives that all firms are required to establish), and any additional objectives it feels necessary to achieve the objective of the system as a whole.
- identify and assess risks to the achievement of the quality objectives. This identification is performed by understanding the **conditions, events, circumstances, actions, or inactions**, that could adversely affect the achievement of the quality objectives. In doing so, the firm is to focus on **the nature and circumstances of the firm and the engagements it performs**.
- design and implement responses to the assessed quality risks. The responses are in the form of policies or procedures. **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 assessment given to the quality risk.**

The firm applies the risk assessment process to each of the other components, except for the monitoring and remediation process. CSQM 1 sets out the quality objectives for each component that all firms would establish. In some cases (e.g., sole practitioners), some of the quality objectives may not be applicable. A smaller firm may perform the risk assessment process holistically rather than contemplate each component separately. Further, responses may address multiple assessed risks. As a result, the SOQM may be simpler for a smaller firm.

Monitoring and remediation process

The firm is required to establish a monitoring and remediation process to provide relevant, reliable, and timely information about the design, implementation and operation of the SOQM. This process allows the firm to remediate deficiencies quickly and reduce the risk of undetected deficiencies.

A. Design and perform monitoring activities

The firm is required to design and perform monitoring activities to provide a basis for the identification of deficiencies.

The nature, timing and extent of monitoring activities can vary depending on the nature and circumstances of the firm and are to be tailored to such. For example, in a small firm, the daily involvement of the partners may provide sufficient information about the effectiveness of the SOQM. There may be no need for a formal monitoring and remediation process.

B. Evaluate findings and identify deficiencies

The second step is for the firm to evaluate findings to determine whether deficiencies exist, including in the monitoring and remediation process. The firm may exercise professional judgment in determining whether findings, individually or in combination with other findings are of such significance that they give rise to a deficiency in the SOQM.

C. Evaluate identified deficiencies

The firm then evaluates the severity and pervasiveness of identified deficiencies by investigating the **root cause** of the identified deficiencies and evaluating the effect of the identified deficiencies, individually and in aggregate, on the SOQM. The objective of a **root cause analysis** is to understand the underlying circumstances that caused the deficiency.

D. Respond to identified deficiencies

The firm needs to respond to the results of the root cause analysis by remediating deficiencies. In some circumstances, the remedial action may include establishing additional objectives, or modifying quality risks or responses because they are inappropriate.

E. Evaluate remedial actions

The individual assigned operational responsibility for the monitoring and remediation process is to evaluate whether the remedial actions are appropriately designed to address the identified deficiencies and their root causes.

F. Evaluate the SOQM

The individual assigned ultimate responsibility and accountability for the system of quality management is required to evaluate the SOQM at least annually. The firm is required to take further action if the conclusion is unsatisfactory. In a smaller firm, the daily involvement of firm leadership may provide information about the system of quality management on a regular basis thus reducing the need for as detailed a monitoring and remediation process and evaluation of the SOQM. A smaller firm is likely more able to revise or introduce new policies or procedures on a timelier basis than a larger firm, thereby responding to issues or concerns around quality as they arise.

Am I required to inspect engagements every year?

The firm is required to include the inspection of completed engagements in its monitoring activities and to determine which engagements and engagement partners to select. The firm is required to inspect at least one completed engagement for each engagement partner on a cyclical basis determined by the firm. CSQM 1 includes application material that suggests the cycle for audits of financial statements may be every three years, while other engagements may be five years.

But it is up to the firm to determine the appropriate cycle. A smaller firm with low-risk engagements and a simple system of quality management may establish a longer cycle. Day to day involvement by firm leadership may provide knowledge of how the system of quality management is applied to individual engagements. Alternatively, one partner may already review completed engagements, possibly already meeting this requirement. How a firm responds is dependent on the nature of the firm and its policies and procedures.

A smaller firm with few partners and staff may find no one is able to perform this inspection because they may all be involved in the engagement. It would be inappropriate for the engagement team to inspect their own work, so in this case, the firm may need to consider hiring an external inspector.

How is CSQM 1 scalable?

The new approach to quality is risk based. The approach is grounded in a risk assessment that identifies elements specific to the firm and the engagements it performs that may give rise to a risk. The quality objectives set by the firm are outcome based. Quality risks identified through the risk assessment process are tailored to the firm, given that the firm focuses on understanding conditions, events, circumstances, actions, or inactions that relate specifically to the nature and circumstances of the firm and the engagements it performs. The firm is to respond to the quality risks through policies or procedures, with very few specified responses required by the standard. As such, a firm which performs only compilation engagements and issues compilation engagement reports may have a less complex SOQM given that it is most likely exposed to fewer quality risks than a firm which performs audits of financial statements of listed entities.

CSQM 2

Why is there a separate standard for engagement quality reviews?

In revising International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements*, the International Auditing and Assurance Standards Board (IAASB) recognized the importance of EQRs and the public interest importance ascribed to it by certain stakeholders. In performing a post implementation review of ISQC 1, the IAASB noted many stakeholders (including oversight bodies) were concerned the requirements for EQRs were not sufficiently robust.

As the IAASB progressed with its revisions to ISQC 1, it determined that the most appropriate location of the requirements and application material in relation to EQRs was a separate standard. The separate standard allows for more robust performance and documentation requirements and improves scalability, as an EQR may not be needed for all engagements. In such a case, the standard would not apply.

What is the relationship between CSQM 1 and CSQM 2?

An EQR is an objective evaluation of the significant judgments made by the engagement team and the conclusions reached. Given it is a firm level response to a quality risk, CSQM 1 requires the firm to establish policies or procedures for those times when an EQR is to be performed. CSQM 2 deals with appointment and eligibility of an engagement quality reviewer and the performance and documentation of the EQR.

Do I need an engagement quality review on all engagements?

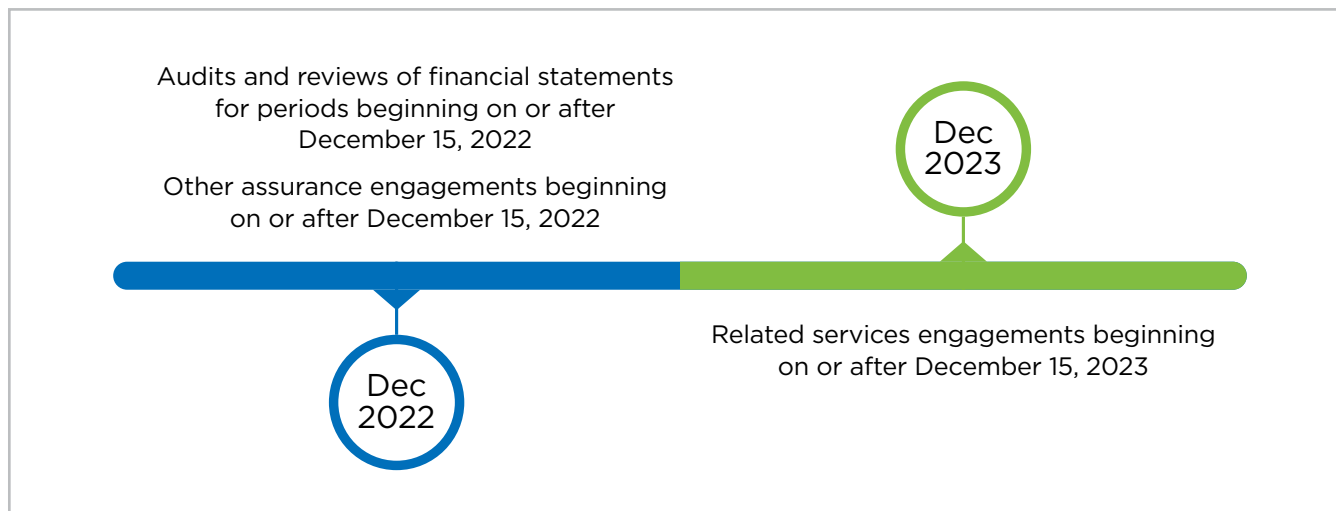
CSQM 1 requires an EQR be performed:

- for audits of financial statements of listed entities
- where required by law or regulation
- where an EQR is identified as an appropriate response to an assessed risk

If none of your engagements meet the above criteria, the performance of an EQR will not be required.

When is CSQM 2 effective?

CSQM 2 is effective for:



What is new?

Under CSQC 1, an engagement quality control review was required for all audits of financial statements of listed entities. The firm was required to establish criteria against which all other audits and reviews of historical financial information and other assurance engagements were assessed to determine whether an engagement quality control review should be performed. CSQC 1 required the firm to establish policies and procedures addressing appointment and eligibility of engagement quality control reviewers and documentation of the engagement quality control review.

CSQM 1 has more explicit requirements for the time when an EQR is required. CSQM 2 requirements address not only the eligibility and objectivity of the engagement quality reviewer, but also the qualifications of the individual(s) responsible for appointing the engagement quality reviewer.

CSQM 2 requires a firm to establish policies or procedures for a cooling-off period of two years, or longer, if required by relevant ethical requirements, before the engagement partner can assume the role of engagement quality reviewer. CSQM 2 also addresses impairment of the engagement quality reviewer's eligibility to perform the review.

CSQM 2 requires the firm to establish robust policies or procedures regarding the performance of the EQR, including:

- that the EQR be performed at appropriate times during the engagement, rather than only before the sign off
- precluding the engagement partner from dating the engagement report until notification has been received from the engagement quality reviewer that the review is complete

CSQM 2 recognizes circumstances when the engagement quality reviewer may use assistants such as an individual or team of individuals with relevant expertise or an individual external to the firm to perform the EQR.

The standard requires the engagement quality reviewer to be responsible for the overall performance of the review, including determining the nature, timing and extent of the direction and supervision of assistants, and the review of their work. When using an individual external to the firm, the requirements in CSQM 1 addressing network requirements/services or services providers apply.

What do I need to know as a first-time implementer?

If your firm only performs related services engagements, you will only need to have an EQR for engagements where there is an assessed quality risk, and where an EQR is an appropriate response to that risk. EQRs are not required for all engagements.

CAS 220

How has CAS 220 been revised?

CAS 220 has been revised to clarify and strengthen the key elements of quality management at the engagement level by:

- emphasizing that the engagement partner is responsible for managing and achieving quality at the engagement level
- clarifying the engagement partner's responsibilities, and acknowledging the engagement partner can assign certain tasks/procedures to members of the engagement team appropriately skilled or suitably experienced in managing and achieving quality
- modernizing the standard for the evolving environment

CAS 220 introduces a stand-back requirement for the engagement partner. Prior to dating the auditor's report, the engagement partner is to determine whether they have been appropriately and sufficiently involved throughout the audit and have a basis for determining that the significant judgments made and conclusions reached are appropriate given the nature and circumstances of the engagement.

How is CAS 220 scalable?

The standard is intended to be applied in the context of the nature and circumstances of each audit. This context includes audits carried out entirely by the engagement partner and audits whose nature and circumstances are more complex. For example, the standard explicitly recognizes that in a smaller firm the policies or procedures may be less formal. In a small firm with few audit engagements, the firm may determine that there is no need to establish a firm-wide system to monitor independence, and rather, it is to be monitored at the individual engagement level by the engagement partner. 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.

When is CAS 220 effective?

CAS 220 is effective for audits of financial statements for periods beginning on or after December 15, 2022.

How can I start to prepare and what resources are available to help me?

Although 2022, or 2023 if your firm performs only related services engagements, seems like a long way off, it will take quite a bit of time to develop a system of quality management.

First steps include:

- reading the standards
- reading the [Basis of Conclusions for CSQM 1](#) (May 2021)
- reading the [Basis of Conclusions for CSQM 2](#) (May 2021)
- reading the [Basis of Conclusions for CAS 220](#) (May 2021)
- reading this *Alert*
- signing up for the upcoming [Practitioner's Pulse webinar](#)
- reading [IAASB quality management guidance](#) resources
- watching for upcoming CPA Canada resources
- starting to reflect on your practice by considering the following:
 - if you have quality control policies and procedures, how the new requirements affect them and what needs to be revised
 - if you do not have quality control policies and procedures, the nature of your firm and your engagements
 - whether you have any engagements where an engagement quality review would be an appropriate response to an assessed risk

CPA Canada plans to host a *Practitioner's Pulse webinar* and publish additional guidance to help you implement these new standards.

Feedback

If you have comments on this *Practitioner's Alert* or suggestions for future *Alerts*, please send them to:

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