

Proposed Exposure Draft: GAGAS Chapter 5, Quality Management and Peer Review

5.01 This chapter addresses the audit organization’s responsibilities for designing, implementing, and operating a system of quality management for engagements conducted in accordance with generally accepted government auditing standards (GAGAS). This chapter includes requirements and application guidance concerning engagement quality reviews that the audit organization may elect to use as a response to one or more quality risks relating to quality management. Finally, the chapter also addresses the audit organization’s responsibilities for administering, planning, performing, and reporting on peer reviews of audit organizations that conduct engagements in accordance with GAGAS. The requirements of this chapter are intended to be followed in conjunction with all other applicable GAGAS requirements.

System of Quality Management

5.02 The objective of a system of quality management for engagements performed in accordance with GAGAS is to provide the audit organization with reasonable assurance that the audit organization and its personnel

- a. fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements; and
- b. perform and report on engagements in accordance with such standards and requirements.

5.03 In GAGAS, a system of quality management addresses the following components: governance and leadership; independence, legal, and ethical requirements; initiation, acceptance, and continuance of engagements; engagement performance; resources; and information and communication. It also includes a process for assessing and responding to risks to achieving the quality objectives and a process for monitoring the system of quality management.

5.04 GAGAS establishes a risk-based approach to designing, implementing, and operating the system of quality management in an interconnected and coordinated manner. This risk-based approach involves the following:

- a. Establishing the desired outcomes relative to the components of the system of quality management (referred to as quality objectives).
- b. Identifying and assessing risks to achieving the quality objectives (referred to as quality risks).
- c. Designing and implementing responses to address quality risks.

Requirements: System of Quality Management

5.05 An audit organization conducting engagements in accordance with GAGAS must design, implement, and operate a system of quality management that provides the audit organization with reasonable assurance that the audit organization and its personnel

- a. fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements; and
- b. perform and report on engagements in accordance with such standards and requirements.

5.06 The audit organization should exercise professional judgment in designing, implementing, and operating a system of quality management, taking into account the nature and circumstances of the audit organization and its engagements.

5.07 Audit organizations subject to the quality management standards of one of the following organizations should comply with the respective organization's quality management requirements and the requirements of paragraphs 5.53a, 5.53b, 5.53d, and 5.71c:

- a. American Institute of Certified Public Accountants
- b. International Auditing and Assurance Standards Board

5.08 Audit organizations not subject to the quality management standards of one of the recognized organizations in paragraph 5.07 should meet the GAGAS quality management requirements in paragraphs 5.05 through 5.130 unless a requirement or an aspect thereof is not relevant to the audit organization because of the nature and circumstances of the audit organization or its engagements.

Application Guidance: System of Quality Management

5.09 The public interest is served by the consistent performance of quality engagements.¹ The design, implementation, and operation of the system of quality management enables the consistent performance of quality engagements by providing the audit organization with reasonable

¹ See paras. 3.07 and 3.08 for additional guidance on the public interest.

assurance that the objective of the system of quality management, stated in paragraph 5.02, is achieved. An audit organization obtains reasonable assurance when the system of quality management reduces to an acceptably low level the risk that the objective stated in 5.02 is not achieved.

5.10 Quality management is not a separate function of the audit organization; it is the integration of a culture that demonstrates a commitment to quality with the audit organization's strategy, operational activities, and business processes. Designing the system of quality management and the audit organization's operational activities and business processes in an integrated manner promotes a harmonious approach to managing the audit organization and enhances the effectiveness of quality management.

5.11 The design of the audit organization's system of quality management, and in particular the complexity and formality of the system, will vary based on the audit organization's circumstances, such as size, number of offices and geographic dispersion, knowledge and experience of its personnel, nature and complexity of its engagement work, and cost-benefit considerations. For example, an audit organization that performs different types of engagements for a wide variety of entities, such as audits of specialized industries or group audits, may need to have a more complex and formalized system of quality management and supporting documentation than an audit organization that performs only reviews of financial statements or agreed-upon procedures engagements. Similarly, a large audit organization with multiple divisions and offices may need to have a more complex and formal system of quality management than a small audit organization with a few auditors at a single location.

5.12 An example of when a requirement of this chapter may not be relevant to an audit organization includes when the audit organization consists of a single auditor. In such a situation, the requirements addressing the organizational structure and assigning roles, responsibilities, and authority within the audit organization; direction, supervision, and review; and addressing differences of opinion may not be relevant.

Responsibility for the System of Quality Management

Requirements: Responsibility for the System of Quality Management

5.13 The audit organization should assign

- a. responsibility and accountability for the system of quality management to a senior-level official within the audit organization; and
- b. operational responsibility for the system of quality management or specific aspects of the system of quality management to a specific individual or individuals.

5.14 The audit organization should determine that the individual(s) in paragraph 5.13

- a. possess the appropriate experience, knowledge, influence, and authority within the audit organization;
- b. have sufficient time to fulfill the assigned responsibility;
- c. have a sufficient understanding of this chapter and other applicable GAGAS requirements, as well as application guidance and other explanatory material, to understand the objectives of quality management and to apply the related requirements properly; and
- d. understand the assigned role(s) and are held accountable for fulfilling them.

5.15 The audit organization should determine that those assigned operational responsibility for the system of quality management or aspects of the system of quality management are in direct communication with the senior-level official assigned responsibility and accountability for the system of quality management.

Application Guidance: Responsibility for the System of Quality Management

5.16 Notwithstanding the assignment of responsibilities related to the system of quality management in accordance with paragraph 5.13, the audit organization remains ultimately responsible for the system of quality management and holding individuals responsible and accountable for

their assigned roles. Further, the audit organization is responsible for its system of quality management even when it uses resources from a service provider as part of its system of quality management.

5.17 The delegation of operational responsibility for the system of quality management or aspects of the system of quality management may depend on the size and complexity of the audit organization. For small or less complex audit organizations, an individual may be assigned operational responsibility for the system of quality management. For large or more complex audit organizations, more than one person may be assigned operational responsibility for the system of quality management or aspects of the system of quality management. For example, aspects of a system of quality management that could be delegated include

- a. compliance with independence requirements,
- b. compliance with continuing professional education requirements,
- c. professional standards, and
- d. the monitoring and remediation process.

The Risk Assessment Process

Requirements: The Risk Assessment Process

5.18 The audit organization should design and implement a risk assessment process that establishes quality objectives, identifies and assesses quality risks, and designs and implements responses to address the quality risks.

5.19 The audit organization should establish the quality objectives specified by this chapter and any additional quality objectives considered necessary by the audit organization to achieve the objective of the system of quality management.

5.20 The audit organization should identify and assess quality risks.

5.21 The audit organization should design and implement responses to address the quality risks in a manner that is based on, and responsive to, quality risk assessments.

5.22 The audit organization should periodically assess whether changes to quality objectives, quality risks, or responses to address quality risks are needed because of changes in the nature and circumstances of the audit organization or its engagements.

Application Guidance: The Risk Assessment Process

5.23 The process of establishing quality objectives, identifying and assessing quality risks, and designing and implementing responses is iterative.

Scalability

5.24 In applying a risk-based approach, the audit organization may take into account

- a. the nature and circumstances of the audit organization and
- b. the nature and circumstances of the engagements that the audit organization performs.

Quality Objectives

5.25 Quality objectives are the desired outcomes to be achieved by the audit organization in relation to the components of the system of quality management.

5.26 The quality objectives specified by this chapter relate to the following components:

- a. Governance and Leadership (5.43)
- b. Independence, Legal, and Ethical Requirements (5.45)
- c. Initiation, Acceptance, and Continuance of Engagements (5.49)
- d. Engagement Performance (5.52)
- e. Resources (5.71)
- f. Information and Communication (5.77)

5.27 There are no quality objectives for the risk assessment process and the monitoring and remediation process because these components are processes.

5.28 The audit organization may determine that a quality objective specified by this chapter, or an aspect thereof, is not relevant because of the nature and circumstances of the audit organization or its engagements.

5.29 The audit organization may identify additional quality objectives

beyond those specified by this chapter that it determines are necessary to achieve the objective of the system of quality management. For instance, laws, regulations, contracts, grant agreements, or professional standards may establish requirements that give rise to additional quality objectives. The audit organization may also determine that additional quality objectives previously established are no longer necessary or need to be modified.

5.30 The need to establish additional quality objectives is not expected to be common. Therefore, not all audit organizations will find it necessary to establish quality objectives beyond those specified in this chapter.

Quality Risks

5.31 Quality risks are risks that have a reasonable possibility of

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

5.32 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 to achieving a quality objective meet the definition of a quality risk. Professional judgment assists the audit organization in determining whether a risk is a quality risk, which is based on the audit organization'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.

5.33 Identifying and assessing quality risks may involve the audit organization

- a. obtaining an understanding of the conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of the quality objectives and
- b. taking into account how, and the degree to which, events, circumstances, actions, or inactions may adversely affect the achievement of the quality objectives.

5.34 Conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of the quality objectives may be related to the nature and circumstances of the audit organization, and may

include

- a. the complexity and operating characteristics of the audit organization;
- b. the strategic and operational decisions and actions of the audit organization;
- c. the characteristics and management style of leadership;
- d. the resources of the audit organization, including the resources provided by service providers; and
- e. law, regulation, professional standards, and the environment in which the audit organization operates.

5.35 Conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of the quality objectives may be related to the nature and circumstances of the engagements performed by the audit organization, and may include

- a. the types of engagements performed by the audit organization and the reports to be issued and
- b. the types of entities for which and upon which such engagements are undertaken.

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

- a. how the condition, event, circumstance, action, or inaction would affect the achievement of the quality objective(s);
- b. how frequently the condition, event, circumstance, action, or inaction is expected to occur;
- c. 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 audit organization would have an opportunity to respond to mitigate its effect; and
- d. how long the condition, event, circumstance, action, or inaction would affect the achievement of the quality objective(s) once it has occurred.

5.37 The assessment of quality risks need not comprise formal ratings or

scores, although audit organizations are not precluded from using them.

5.38 If the audit organization determines that no risks are quality risks for a specific quality objective, then the audit organization is not required to design and implement a response for that quality objective.

Responses

5.39 Responses are the policies or procedures that the audit organization designs and implements to address one or more quality risks.

5.40 The nature, timing, and extent of the responses are based on the assessments of the quality risks, that is, the conclusions from the consideration of how, and the degree to which, conditions, events, circumstances, actions, or inactions may adversely affect the achievement of one or more quality objectives.

5.41 Given the evolving nature of the system of quality management, the responses that the audit organization designs and implements may give rise to conditions, events, circumstances, actions, or inactions that result in further quality risks.

5.42 The responses that the audit organization designs and operates may operate at the audit organization level or engagement level, or there may be a combination of responsibilities for actions to be taken at the audit organization and engagement level.

Governance and Leadership

Requirement: Governance and Leadership

5.43 The audit organization should establish quality objectives that address its governance and leadership as follows:

- a. The audit organization demonstrates a commitment to quality through a culture that exists throughout the audit organization.
- b. Leadership is responsible and accountable for quality.
- c. Leadership demonstrates a commitment to quality through its actions and behaviors.
- d. The organizational structure and assignment of roles, responsibilities, and authority is appropriate to enable the design, implementation, and operation of the audit organization's system

of quality management.

- e. Resource needs are planned for, obtained, allocated, and assigned in a manner consistent with the audit organization's commitment to quality.

Application Guidance: Governance and Leadership

5.44 Demonstrating a commitment to quality through a culture that exists throughout the audit organization may include recognizing and reinforcing the following:

- a. the audit organization's role in serving the public interest by consistently performing quality engagements;
- b. the importance of professional ethics, values, and attitudes;
- c. 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; and
- d. the importance of quality in the audit organization's strategic decisions and actions.

Independence, Legal, and Ethical Requirements

Requirements: Independence, Legal, and Ethical Requirements

5.45 The audit organization should establish a quality objective that addresses fulfilling relevant independence, legal, and ethical requirements as follows:

The audit organization and its personnel understand and fulfill their responsibilities in relation to the relevant independence, legal, and ethical requirements to which the audit organization and its personnel are subject.²

5.46 As part of designing and implementing responses to address quality risks that adversely affect the achievement of the quality objective in paragraph 5.45, the audit organization should:

²See paras. 3.02 through 3.16 for a discussion of ethical principles and paras. 3.18 through 3.108 for independence requirements and guidance.

- a. establish policies and procedures for identifying, evaluating, and addressing threats to compliance with the relevant independence, legal, and ethical requirements and appropriately responding to the causes and consequences of any breaches of these requirements; and
- b. at least annually, obtain written affirmation of compliance with its policies and procedures on independence from all of its personnel required to be independent.

Application Guidance: Independence, Legal, and Ethical Requirements

5.47 Policies and procedures pertaining to independence, legal, and ethical requirements assist the audit organization in

- a. communicating its independence requirements to its personnel and
- b. identifying and evaluating circumstances and relationships that create threats to independence and taking appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards or, if considered appropriate, withdrawing from the engagement where withdrawal is not prohibited by law or regulation. (Extant 5.10)

5.48 Written affirmation of compliance with its policies and procedures on independence from all audit organization personnel required to be independent may be in paper or electronic form. By obtaining affirmation of retrospective compliance with the audit organization's policies and procedures on independence during a specified period and taking appropriate action on information indicating noncompliance, or potential noncompliance, the organization demonstrates the importance that it attaches to independence and keeps the issue current for, and visible to, its personnel. An audit organization may obtain affirmation of required personnel's compliance with policies and procedures on independence more frequently than once per year. For example, affirmation may be obtained on a per-engagement basis when such engagements last less than 1 year. (Extant 5.11)

Acceptance, Initiation, and Continuance of Engagements

Requirement: Acceptance, Initiation, and Continuance of Engagements

5.49 The audit organization should establish a quality objective that addresses the acceptance, initiation, and continuance of engagements as follows:

The audit organization accepts, initiates, and continues engagements only if it

- a. complies with professional standards, applicable legal and regulatory requirements, and ethical principles, including those related to independence;
- b. acts within its legal mandate or authority; and
- c. has the capabilities, including time and resources, to do so.

Application Guidance: Acceptance, Initiation, and Continuance of Engagements

5.50 Government audit organizations may initiate engagements as a result of (1) legal mandates, (2) requests from legislative bodies or oversight bodies, and (3) audit organization discretion. In the case of legal mandates and requests, a government audit organization may be required to conduct the engagement and may not be permitted to make decisions about acceptance or continuance or to resign or withdraw from the engagement. (Extant 5.13)

5.51 Audit organizations may operate with limited resources. Audit organizations may consider their workloads in determining whether they have the resources to perform quality engagements over the range of work. To achieve this, audit organizations may develop systems to prioritize their work in a way that takes into account the need to maintain quality. (Extant 5.14)

Engagement Performance

Requirement: Engagement Performance

5.52 The audit organization should establish quality objectives that address the performance of quality engagements as follows:

- a. Engagement teams understand and fulfill their responsibilities in connection to engagements, including the overall responsibility of an engagement partner or director for
 - i. managing and achieving quality on the engagement and
 - ii. being sufficiently and appropriately involved throughout the engagement.
- 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 and the resources assigned or made available to the engagement team.
- c. Engagement teams exercise appropriate professional judgment, which includes exercising reasonable care and professional skepticism.³
- d. Consultation on significant matters is undertaken, especially for difficult or contentious matters, and the conclusions agreed to are implemented and, as appropriate, documented.
- e. Differences of opinion within the engagement team, or between the engagement team and individuals performing activities within the audit organization's system of quality management, are brought to the attention of officials at the appropriate level of the audit organization and resolved.
- f. Engagement documentation is assembled on a timely basis and is appropriately maintained and retained to meet the needs of the audit organization and comply with law, regulation, relevant ethical requirements, and professional standards.

5.53 As part of designing and implementing responses to address quality risks that adversely affect the achievement of the quality

³See paras. 3.109 through 3.117 for a discussion of professional judgment.

objectives in paragraph 5.52, the audit organization should establish policies and procedures for

- a. communicating the identity and role of the engagement partner or director to management and those charged with governance of the audited entity; (Extant 5.37a)
- b. if auditors change the engagement objectives during the engagement, documenting the revised engagement objectives and the reasons for the changes; (Extant 5.23)
- c. requiring that engagement team members with appropriate levels of skill and proficiency supervise engagements and review work that other engagement team members perform;
- d. if an engagement is terminated before it is completed and an audit report is not issued, documenting the results of the work to the date of termination and why the engagement was terminated; and (Extant 5.25)
- e. identifying whether an engagement quality review is an appropriate response to address one or more quality risks.⁴

Application Guidance: Engagement Performance

5.54 Appropriate teamwork and training help less experienced members of the engagement team to clearly understand the objectives of the assigned work. (Extant 5.38)

5.55 Engagement supervision includes the following:

- a. tracking the progress of the engagement;
- b. considering the competence of individual members of the engagement team, whether they understand their instructions, and whether the work is being carried out in accordance with the planned approach to the engagement;
- c. addressing significant findings and issues arising during the engagement, considering their significance, and modifying the planned approach appropriately; and

⁴See paras. 5.135 through 5.148 for requirements and application guidance on performing engagement quality reviews.

- d. identifying matters for consultation or consideration by engagement team members with appropriate levels of skill and proficiency in auditing, specialists, or both during the engagement. (Extant 5.39)

5.56 A review of the work performed includes consideration of whether

- a. the work has been performed in accordance with professional standards and applicable legal and regulatory requirements;
- b. significant findings and issues have been raised for further consideration;
- c. appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- d. the nature, timing, and extent of the work performed is appropriate and without need for revision;
- e. the work performed supports the conclusions reached and is appropriately documented;
- f. the evidence obtained is sufficient and appropriate to support the report; and
- g. the objectives of the engagement procedures have been achieved. (Extant 5.40)

5.57 In the case of an audit organization consisting of a single auditor, the requirement for a second auditor to review work performed and related documentation may be achieved through alternative procedures. (Extant 5.41)

5.58 Consultation involves a discussion at the appropriate professional level with individuals within or outside the audit organization who have specialized expertise. (Extant 5.29)

5.59 Consultation uses appropriate research resources, as well as the collective experience and technical expertise of the audit organization. Consultation helps promote quality and improves the application of professional judgment. (Extant 5.30 (partial))

5.60 Effective consultation on significant technical, ethical, and other matters within the audit organization or, when applicable, outside the audit organization can be achieved when

- a. those consulted are given all the relevant facts that will enable

them to provide informed advice;

b. those consulted have appropriate knowledge, authority, and experience; and

c. conclusions resulting from consultations are appropriately documented and implemented. (Exant 5.31)

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

5.62 The audit organization 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.

5.63 The appropriate level of official to whom differences of opinion are raised may vary. For example, a partner or director may be an appropriate level of official to resolve differences of opinion in the engagement team. The senior-level official assigned accountability and responsibility for the system of quality management may be an appropriate level of official to resolve differences of opinion between the engagement team and individuals performing activities within the audit organization's system of quality management.

5.64 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.

5.65 Whether engagement documentation is in paper, electronic, or other form, the integrity, accessibility, and retrievability of the underlying information could be compromised if the documentation is altered, added to, or deleted without the auditors' knowledge or if the documentation is lost or damaged.

5.66 Law, regulation, or professional standards may prescribe the retention periods for engagement documentation. If the retention periods are not prescribed, the audit organization may consider the nature of the engagements that the audit organization performs and the audit organization's circumstances.

5.67 Determining whether and how to communicate the reason for terminating an engagement or changing the engagement objectives to

those charged with governance, appropriate officials of the audited entity, the entity contracting for or requesting the engagement, and other appropriate officials will depend on the facts and circumstances and therefore is a matter of professional judgment. (Extant 5.35)

5.68 An engagement quality review is an objective evaluation of the engagement team's significant judgments and the conclusions reached thereon performed by the engagement quality reviewer and completed on or before the date of the audit report.

5.69 The determination that an engagement quality review is an appropriate response to address one or more quality risks may apply to all GAGAS engagements, specific types of GAGAS engagements, or specifically identified GAGAS engagements.

5.70 The audit organization's responses to address quality risks may include other forms of engagement reviews that are not an engagement quality review. The audit organization may determine that engagement quality reviews may not be necessary to address quality risks.

Resources

Requirement: Resources

5.71 The audit organization should establish 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 a system of quality management as follows:

- a. Personnel are hired, developed, and retained who have the competence and capabilities to consistently perform quality engagements and carry out responsibilities related to the operation of the audit organization's system of quality management.
- b. Personnel develop and maintain the appropriate competence to perform their roles and are held accountable or recognized for doing so through timely evaluations, compensation, promotion, and other incentives.
- c. Auditors who are performing work in accordance with GAGAS meet the continuing professional education (CPE) requirements (Note: Change made to extant 5.16).

- d. The audit organization has sufficient resources to perform quality engagements consistently and enable the operation of the audit organization's system of quality management.
- e. Individuals assigned to engagements or to perform activities within the system of quality management have appropriate competence and capabilities, including sufficient time, to perform their duties.
- f. Appropriate technological and intellectual resources are obtained or developed, implemented, maintained, and used to enable the operation of the audit organization's system of quality management and the performance of engagements.
- g. Human, technological, or intellectual resources from service providers are appropriate for use in the audit organization's system of quality management and in performing engagements.

Application Guidance: Resources

5.72 The policies or procedures designed and implemented relating to hiring, developing, and retaining personnel may address issues such as the following:

- a. recruiting individuals who have, or are able to develop, appropriate competence;
- b. training programs focused on developing personnel's competence and continuing professional development;
- c. evaluation mechanisms that are undertaken at appropriate intervals and include competency areas and other performance measures; and
- d. compensation, promotion, and other incentives for all personnel, including engagement partners or directors and those assigned roles and responsibilities related to the audit organization's system of quality management.

5.73 Effective performance evaluation, compensation, and advancement procedures give due recognition and reward to developing and maintaining competent personnel. Steps that an audit organization may take in developing and maintaining competent personnel include the following:

- a. making personnel aware of the audit organization's expectations

regarding performance and ethical principles;

- b. providing personnel with an evaluation of, and counseling on, performance, progress, and career development; and
- c. helping personnel understand that compensation and advancement to positions of greater responsibility depend on, among other things, performance quality, and that failure to comply with the audit organization's policies and procedures may result in disciplinary action. (Exant 5.19)

5.74 The size and circumstances of the audit organization are important considerations in determining the structure of the audit organization's performance evaluation process. A smaller audit organization, in particular, may employ less formal methods of evaluating the performance of its personnel. (Exant 5.20)

5.75 The audit organization may use a suitably qualified external person to conduct engagement work when internal resources, for example, personnel with particular areas of technical expertise, are unavailable. (Exant 5.18)

5.76 Intellectual resources include the information that the audit organization uses to enable the operation of the system of quality management and promote consistency in performing engagements. Examples of intellectual resources included written policies and procedures, methodologies, guides, standardized documentation, and access to information sources such as subscription-based databases.

Information and Communication

Requirement: Information and Communication

5.77 The audit organization should establish quality objectives that address obtaining, generating, or using information regarding the system of quality management and communicating information to enable the design, implementation, and operation of the system of quality management as follows:

- a. The audit organization's information system identifies, captures, processes, and maintains relevant and reliable information that supports the system of quality management.
- b. Relevant and reliable information is communicated to personnel and engagement teams to enable them to understand and carry

out their responsibilities within the system of quality management or engagements.

- c. Personnel and engagement teams communicate to the audit organization when performing activities within the system of quality management or engagements.
- d. Relevant and reliable information is communicated to external parties.

Application Guidance: Information and Communication

5.78 Obtaining, generating, or communicating information is generally an ongoing process that involves all personnel and encompasses disseminating information within the audit organization and externally. Information and communication are part of all components of the system of quality management.

5.79 Relevant and reliable information includes information that is accurate, complete, timely, and valid to enable the proper functioning of the system of quality management and to support decisions regarding the system of quality management.

5.80 The audit organization may recognize and reinforce the responsibility of personnel and engagement teams to exchange information with the audit organization and one another by establishing communication channels to facilitate communication across the audit organization.

5.81 Laws, regulations, and professional standards may require information to be communicated externally, particularly to support external parties' understanding of the system of quality management.

Scalability

5.82 The complexity and formality of an audit organization's mechanisms for communicating with personnel or engagement teams information relevant to the system of quality management will vary. For example, a smaller or less complex audit organization may find informal staff meetings effective for communicating with personnel or engagement teams. A larger or more complex audit organization may need formal mechanisms, such as written reports, intranet portals, or periodic official meetings, for communicating such information.

Monitoring and Remediation Process

Requirement: Monitoring and Remediation Process

5.83 The audit organization should establish a process to monitor the design, implementation, and operation of the system of quality management to provide a basis for identifying deficiencies and remediating them in a timely basis.

Application Guidance: Monitoring and Remediation Process

5.84 Monitoring of quality is a process comprising an ongoing consideration and evaluation of the audit organization's system of quality management, including inspection of engagement documentation and reports for a selection of completed engagements. The purpose of monitoring is to provide management of the audit organization with reasonable assurance that (1) the policies and procedures related to the system of quality management are suitably designed and operating effectively in practice, (2) auditors have fulfilled their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and (3) auditors have performed and reported on engagements in accordance with such standards and requirements.

5.85 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.

Requirement: Designing and Performing Monitoring Activities

5.86 The audit organization should design monitoring and remediation activities to

- 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 they are remediated on a timely basis.
- c. enable it to assess compliance with professional standards and with policies and procedures it has established to address quality risks.

5.87 The audit organization should establish policies and procedures that require the individuals performing the monitoring activities to be objective and have sufficient competence, authority, and time to perform these activities.

Application Guidance: Designing and Performing Monitoring Activities

5.88 Monitoring is most effective when performed by persons who do not have responsibility for the specific activity being monitored. (Extant 5.48)

5.89 Monitoring activities will vary based on the audit organization's facts and circumstances.

5.90 In determining the nature, timing, and extent of the monitoring activities, the audit organization may take the following into account:

- a. The quality risk assessments.
- b. The design of the responses.
- c. The design of the audit organization's risk assessment process and monitoring and remediation process.
- d. Changes in the system of quality management.
- e. The results of previous monitoring activities, including whether
 - i. previous monitoring activities continue to be relevant in evaluating the audit organization's system of quality management and
 - ii. remedial actions to address previously identified deficiencies were effective.
- f. Other relevant information, including
 - i. complaints and allegations about
 - a. failures to perform work in accordance with professional standards and applicable legal and regulatory requirements or
 - b. noncompliance with the audit organization's policies or procedures related to the system of quality management and

ii. information from inspections.

5.91 Inspection is a retrospective evaluation of the adequacy of the audit organization's quality management policies and procedures, its personnel's understanding of those policies and procedures, and the extent of the audit organization's compliance with them.

5.92 The audit organization'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 audit organization's processes and performed on a real-time basis. Periodic monitoring activities are conducted at certain intervals by the audit organization.

5.93 Reviews of the work by engagement team members prior to the date of the report are not monitoring procedures. (Extant 5.53)

5.94 When performing monitoring activities, the audit organization 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.

5.95 How the audit organization'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 audit organization's risk assessment process.

5.96 Changes in the system of quality management may include

- a. changes to address an identified deficiency in the system of quality management and
- b. changes to the quality objectives, quality risks, or responses resulting from changes in the nature and circumstances of the audit organization and its engagements.

5.97 When changes in the system of quality management occur, the audit organization's previous monitoring activities may no longer provide it with information to support the evaluation of the system of quality management. Therefore, the audit organization's monitoring activities may include monitoring of those changes.

5.98 The results of inspections or other relevant information may indicate

that previous monitoring activities that the audit organization undertook failed to identify a deficiency in the system of quality management. This information may affect the audit organization's consideration of the nature, timing, and extent of the monitoring activities.

5.99 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 audit organization's policies and procedures related to engagement performance) have been implemented as designed and are operating effectively.

5.100 The extent of inspection procedures depends, in part, on the existence and effectiveness of the other monitoring procedures. The nature of inspection procedures varies based on the audit organization's quality management policies and procedures and the effectiveness and results of other monitoring procedures. (Extant 5.54)

5.101 The audit organization may inspect a selection of completed engagements on a cyclical basis. The manner in which the inspection cycle is organized, including the timing of selection of individual engagements, depends on many factors, such as the following:

- a. the size of the audit organization;
- b. the number and geographical location of offices;
- c. the results of previous monitoring procedures;
- d. the degree of authority of both personnel and office (for example, whether individual offices are authorized to conduct their own inspections or whether only the head office may conduct them);
- e. the nature and complexity of the audit organization's practice and structure; and
- f. the risks associated with entities that the audit organization audits and its specific engagements. (Extant 5.55)

5.102 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, an audit organization's quality management policies and procedures may provide that a peer review conducted under standards established by this chapter may be a substitute for inspection procedures.

5.103 The audit organization may consider provisions of relevant ethical requirements when designing the policies or procedures addressing the objectivity of the individuals performing the monitoring activities.

Examples of threats to objectivity include when:

- a. an individual who performs an inspection of an engagement was an engagement team member or the engagement quality reviewer for that engagement and
- b. an individual who performs another type of monitoring activity participated in designing, executing, or operating the response being monitored.

Requirement: Evaluating Findings and Identifying Deficiencies

5.104 The audit organization should evaluate findings concerning the system of quality management to determine whether deficiencies exist.

Application Guidance: Evaluating Findings and Identifying Deficiencies

5.105 A deficiency in the audit organization's system of quality management exists when

- a. a quality objective required to achieve the objective of the system of quality management is not established;
- b. a quality risk, or combination of quality risks, is not identified or properly assessed;
- c. 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
- d. another aspect of the system of quality management is absent, or not properly designed, implemented, or operating effectively, such that a requirement of this chapter has not been addressed.

5.106 A finding in relation to a system of quality management is information about the design, implementation, and operation of the system of quality management that has been accumulated from the performance of monitoring activities and other relevant sources, which indicates that one or more deficiencies may exist.

5.107 The audit organization accumulates findings from monitoring activities, external inspections, and other relevant sources. Information that the audit organization accumulates from the monitoring activities and other relevant sources may lead to observations about the audit organization's system of quality management, such as

- a. 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
- b. similar circumstances in which no findings were noted (for example, engagements in which no findings were noted but the engagements have a similar nature to the engagements in which findings were noted).

5.108 The information that the audit organization accumulates from the monitoring activities and other relevant sources may also lead to other observations that may be useful to the audit organization because they may assist it in investigating the underlying causes of identified deficiencies, indicate practices that the audit organization can support or apply more extensively (for example, across all engagements), or highlight opportunities for the audit organization to enhance its system of quality management. The results of the monitoring and remediation process provide information about the operation of the system of quality management that is relevant to the audit organization's risk assessment process.

5.109 The audit organization 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 audit organization may 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 audit organization's judgments may be affected by quantitative and qualitative factors relevant to the findings. In some circumstances, the audit organization may determine it appropriate to obtain more information about the findings in order to determine whether a deficiency exists. Not all findings, including findings about specific engagements, will be a deficiency.

5.110 Evaluating findings and identifying deficiencies and evaluating the severity and pervasiveness of an identified deficiency, including investigating the underlying causes of an identified deficiency, are part of an iterative process.

Requirement: Evaluating Identified Deficiencies

5.111 The audit organization should evaluate the severity and pervasiveness of identified deficiencies in the system of quality management by investigating their underlying causes and evaluating their effect, both individually and in the aggregate, on the system of quality management.

Application Guidance: Evaluating Identified Deficiencies

5.112 Factors the audit organization may consider in evaluating the severity and pervasiveness of an identified deficiency include the following:

- a. the nature of the identified deficiency, including the aspect of the audit organization'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
- b. in the case of identified deficiencies related to responses, whether there are compensating responses to address the quality risk to which the response relates
- c. the underlying causes of the identified deficiency
- d. the frequency with which the matter giving rise to the identified deficiency occurred
- e. the magnitude of the identified deficiency, how quickly it occurred, and its duration and effect on the system of quality management

5.113 The severity and pervasiveness of identified deficiencies affect the evaluation of the system of quality management that is undertaken by the senior-level official assigned responsibility and accountability for the system of quality management.

5.114 The nature, timing, and extent of the procedures undertaken to understand the underlying causes of an identified deficiency may also be affected by the nature and circumstances of the audit organization, such as the following:

- a. The complexity and operating characteristics of the audit organization.
- b. The size of the audit organization.

- c. The geographical dispersion of the audit organization.
- d. How the audit organization is structured or the extent to which the audit organization concentrates or centralizes its processes or activities.

Requirement: Responding to Identified Deficiencies

5.115 The audit organization should design and implement remedial actions that respond to the results of the analysis of underlying causes to address identified deficiencies in the system of quality management.

5.116 The audit organization should evaluate the remedial actions to determine whether they are effective in addressing the identified quality management deficiencies and their related underlying causes.

5.117 If the audit organization's evaluation indicates that the remedial actions are not effective in addressing the quality management deficiencies, the audit organization should modify the remedial actions such that identified deficiencies and their related underlying causes are addressed.

Findings About a Particular Engagement

5.118 The audit organization should respond to circumstances when findings indicate that there is an engagement for which

- a. required procedures were omitted during the performance of the engagement or
- b. the report issued may not comply with professional standards and applicable legal and regulatory requirements.

Application Guidance: Responding to Identified Deficiencies

5.119 In some circumstances, the remedial action may include establishing additional quality objectives, or adding or modifying quality risks or responses, to address identified deficiencies.

Findings About a Particular Engagement

5.120 When findings indicate that required procedures were omitted during the performance of an engagement or that the report may not comply with professional standards and applicable legal and regulatory

requirements, responses could include

- a. taking action to comply with relevant professional standards and applicable legal and regulatory requirements or
- b. when the report may not comply with professional standards and applicable legal and regulatory requirements, taking appropriate action, including considering whether to obtain legal advice.

Requirements: Ongoing Communication Related to Monitoring and Remediation

5.121 The audit organization should communicate to appropriate personnel, including the senior-level official assigned responsibility and accountability for the system of quality management, and relevant engagement partner(s) or director(s), the following:

- a. a description of the monitoring activities performed;
- b. the identified deficiencies, including the severity and pervasiveness of such deficiencies; and
- c. the remedial actions to address identified deficiencies.

5.122 The audit organization should communicate the matters described in paragraph 5.121 to engagement teams and others within the system of quality management to enable the audit organization and appropriate personnel to take prompt remedial action related to deficiencies in accordance with their responsibilities.

Application Guidance: Ongoing Communication Related to Monitoring and Remediation

5.123 The information communicated about the monitoring and remediation to the senior-level official assigned responsibility and accountability for the system of quality management may be communicated on an ongoing basis or periodically.

Evaluating the System of Quality Management

Requirements: Evaluating the System of Quality Management

5.124 The senior-level official assigned responsibility and accountability for the audit organization's system of quality management should

evaluate the system of quality management at least annually.

5.125 Based on the evaluation in paragraph 5.124, the senior-level official assigned responsibility and accountability for the audit organization's system of quality management should conclude one of the following:

- a. The system of quality management provides the audit organization with reasonable assurance that the objective of the system of quality management is being achieved.
- 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 audit organization with reasonable assurance that the objective of the system of quality management is being achieved.
- c. The system of quality management does not provide the audit organization with reasonable assurance that the objective of the system of quality management is being achieved.

Application Guidance: Evaluating the System of Quality Management

5.126 In concluding on the system of quality management, the senior-level official assigned responsibility and accountability for the system of quality management may consider the results of the monitoring and remediation process.

5.127 There may be circumstances when identified deficiencies that are severe (including identified deficiencies that are severe and pervasive) have been appropriately remediated and their effect corrected at the point in time of the evaluation. In such cases, the senior-level official assigned responsibility and accountability for the system of quality management may conclude that the system of quality management provides the audit organization with reasonable assurance that the objective of the system of quality management is being achieved.

Documentation

Requirements: Documentation

5.128 The audit organization should document its system of quality management and communicate this information to its personnel in a manner sufficient to

- a. support personnel's consistent understanding of the system of quality management, 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; and
- c. provide evidence of the design, implementation, and operation of the responses to support the evaluation of the system of quality management by the senior-level official assigned responsibility and accountability for the system of quality management.

5.129 The audit organization should include the following in its documentation of its system of quality management:

- a. Identification of the
 - i. senior-level official assigned responsibility and accountability for the system of quality management and
 - ii. individual(s) assigned operational responsibility for the system of quality management;
- b. The audit organization's quality risk assessment, including its quality objectives, quality risks, and a description of the responses and how the audit organization's responses address the quality risks;
- c. Regarding the monitoring and remediation process,
 - i. evidence of the monitoring activities performed;
 - ii. the evaluation of findings, and identified deficiencies and their related underlying causes;
 - iii. remedial actions to address identified deficiencies and the evaluation of the design and implementation of such remedial actions; and
 - iv. communications about monitoring and remediation.

- d. The basis for the conclusion reached pursuant to paragraph 5.125

5.130 The audit organization should establish a period of time for document retention for the system of quality management that is sufficient to enable the audit organization and its peer reviewer to monitor the design, implementation, and operation of the system of quality management or for a longer period if required by law or regulation.

Application Guidance: Documentation

5.131 An audit organization's judgments about the form, content, and extent of documentation may be affected by factors related to the nature and complexity of the audit organization and engagements performed. Areas of greater quality risk, matters involving more complex judgments, and changes to aspects of the system of quality management may have greater impact on the form, content, and extent of documentation.

5.132 In some instances, an external oversight authority may establish additional documentation requirements, either formally or informally, as a result of inspection findings, external peer review results, or for reasons that the external oversight authority deems necessary.

5.133 The audit organization 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.

5.134 In documenting the quality risks and how the audit organization's responses address the quality risks, the audit organization may document the assessments given to the quality risk (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.

Engagement Quality Reviews

5.135 This section establishes requirements for audit organizations that elect to conduct engagement quality reviews as a response to address quality risks. An engagement quality review is an objective evaluation of the engagement team's significant judgments and the conclusions reached thereon.

5.136 The audit organization may determine that an engagement quality review is an appropriate response to address one or more quality risks applicable to all GAGAS engagements, specific types of GAGAS engagements, or specifically identified GAGAS engagements. The audit organization may determine that engagement quality reviews are not necessary to address quality risks.

Requirements: Eligibility to Serve as an Engagement Quality Reviewer

5.137 An audit organization using engagement quality reviews should establish policies or procedures that set forth the criteria for eligibility to be appointed as an engagement quality reviewer or an assistant to an engagement quality reviewer. The policies or procedures should require that any engagement quality reviewer and any assistants to an engagement quality reviewer not be members of the engagement team; and

- a. have the competence and capabilities, including sufficient time, and the appropriate authority to perform the engagement quality review; and
- b. comply with relevant legal and ethical requirements, including those addressing threats to the objectivity of the engagement quality reviewer.

Application Guidance: Eligibility to Serve as an Engagement Quality Reviewer

5.138 The audit organization may consider threats to objectivity created by an individual being appointed as the engagement quality reviewer after having been previously assigned to the engagement. In recurring engagements, the matters on which significant judgments are made often do not vary. Significant judgments made in prior engagements may continue to affect the engagement team's judgments in subsequent engagements. Therefore, the ability of an engagement quality reviewer to perform an objective evaluation of significant judgments may be affected when the individual was previously involved with those judgments. In such circumstances, it is important that appropriate safeguards are put in place to reduce threats to objectivity to an acceptable level.

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

5.139 An audit organization using engagement quality reviews should establish policies and 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 audit organization. The audit organization should include in such policies and procedures notification to appropriate individuals within the audit organization if the engagement quality reviewer becomes aware of circumstances that impair the engagement quality reviewer's eligibility.

Requirements: Performance of the Engagement Quality Review

5.140 An audit organization using engagement quality reviews 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 at appropriate points in time during the engagement to provide an appropriate basis for an objective evaluation of the engagement team's significant judgments and the conclusions reached thereon.
- b. The responsibilities of the engagement partner or director in relation to the engagement quality review, including that
 - i. the engagement partner or director is precluded from releasing the audit report until notification has been received from the engagement quality reviewer that the engagement quality review is complete and
 - ii. documentation is provided to the engagement quality reviewer to permit completion of the engagement quality review.
- 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 engagement quality reviewer's objectivity and appropriate actions to take in these circumstances.

5.141 In performing an engagement quality review, the engagement quality reviewer should do the following:

- a. Read and obtain an understanding about information communicated to the engagement quality reviewer by the
 - i. engagement team regarding the nature and circumstances of the engagement and the entity and
 - ii. audit organization related to the organization'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 or director and, if applicable, other members of the engagement team, significant matters and significant judgments made in planning, performing, and reporting on the engagement.
- c. Based on the information obtained in paragraph 5.141 (a) and (b), review selected engagement documentation relating to the engagement team's significant judgments and evaluate the following:
 - i. The basis for making those significant judgments, including, when applicable to the type of engagement, the engagement team's exercise of professional skepticism
 - 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 or director's determination that relevant ethical requirements have been fulfilled.
- 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.
- f. For audits of financial statements, evaluate the basis for the engagement partner's or director's determination that the engagement partner's or director's involvement has been sufficient and appropriate throughout the audit engagement such that the engagement partner or director has the basis for determining that the significant judgments made and the

conclusions reached are appropriate given the nature and circumstances of the engagement.

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;
- ii. for reviews of financial statements or financial information, the financial statements or financial information and the audit report thereon; or
- iii. for other engagements, the audit report, and when applicable, the subject matter information.

5.142 If an engagement quality reviewer has concerns that the engagement team's significant judgments or conclusions are not appropriate, the engagement quality reviewer should notify the engagement partner or director. If such concerns are not resolved to the engagement quality reviewer's satisfaction, the engagement quality reviewer should notify appropriate individuals in the audit organization that the engagement quality review cannot be completed.

Application Guidance: Performance of the Engagement Quality Review

5.143 Frequent communication between the engagement team and engagement quality reviewer throughout the engagement may facilitate an effective and timely engagement quality review. However, a threat to the objectivity of the engagement quality reviewer may be created if the engagement quality reviewer is, or may be perceived to be, making decisions on behalf of the engagement team.

5.144 The audit organization's policies or procedures may specify the nature, timing, and extent of the procedures that the engagement quality reviewer performs and also may emphasize the importance of the engagement quality reviewer exercising professional judgment in performing the review.

5.145 The audit organization's policies or procedures may specify the individual(s) in the audit organization to be notified if the engagement quality reviewer has unresolved concerns that the engagement team's significant judgments or conclusions are not appropriate. With respect to

such unresolved concerns, the audit organization's policies or procedures may also require consultation within or outside the audit organization.

Requirement: Completion of the Engagement Quality Review

5.146 When an engagement quality review is performed for a GAGAS engagement, the engagement quality reviewer should notify the engagement partner or director when the engagement quality review is complete.

Requirement: Engagement Quality Review Documentation

5.147 When an engagement quality review is conducted for a GAGAS engagement, the engagement quality reviewer should document:

- a. the names of the engagement quality reviewer and individuals who assisted with the engagement quality review;
- b. that the procedures required by the audit organization's policies on engagement quality reviews have been performed;
- c. that the engagement quality reviewer is not aware of any unresolved matters that would cause the engagement quality reviewer to believe that the significant judgments that the engagement team made and the conclusions it reached were not appropriate;
- d. the notifications required in accordance with paragraphs 5.142 and 5.146; and
- e. the date of completion of the engagement quality review.

Application Guidance: Engagement Quality Review Documentation

5.148 The form, content, and extent of the documentation of the engagement quality review may vary based on factors such as

- a. the nature and complexity of the engagement;
- b. the nature of the entity;
- c. the nature and complexity of the matters subject to the engagement quality review; or
- d. the extent of the engagement documentation reviewed.

Note: No changes to the External Peer Review section are proposed, and thus section is removed from the draft. Conforming changes from quality control to quality management throughout the Yellow Book will be made at a later date.

DRAFT