QUALITY MANAGEMENT IN CONDUCTING AN AUDIT OF FINANCIAL STATEMENTS

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ABSTRACT

The International Auditing and Assurance Standards Board (IAASB) has finalized new standards for audit quality control, one of which discloses the provisions of quality management in auditing financial statements. The purpose of this article is to analyze the changes that have been made by the International Standards on Auditing Board in order to improve the quality of auditing, namely in International Standard on Auditing (ISA) 220 Quality control for an audit of financial statements. The article examines the components of the audit firm's quality control system, while paying attention to two new components in the audit firm's quality control system. In conclusion, proposals are made for improving the quality control system of an audit firm, taking into account changes in International Standards on Auditing (ISA).

KEYWORDS: *audit, quality control, audit risks, quality management elements*

JEL CLASSIFICATIONS: M42

INTRODUCTION

The issues of quality control of audit of financial statements at the level of an audit firm have recently become very important. In this regard, in September 2020, at its meeting, the International Auditing and Assurance Standards Board (IAASB) presented the final version of the updated International Auditing Standard 220, which became the result of a large-scale project to improve audit quality. It should be noted that the current ISA 220 "Quality control in the audit of financial statements" in the updated format has changed its name to ISA 220 "Quality Management for an Audit of Financial Statements" is in force at the beginning and establishes the requirements for quality control when auditing financial statements.

In accordance with the provisions of this standard, it is the responsibility of the audit firm to establish a system, policies and procedures for quality control that provide reasonable assurance that: the firm and its employees comply with professional standards and applicable legal and regulatory requirements and the opinions issued by the firm are appropriate in the specific circumstances.

Responsibilities of the audit firm to implement a quality control system, which, in accordance with the provisions of ISA 220"Quality control in the audit of financial statements" [1], must contain the following elements:

• *management responsibility for quality within the firm;*
• *relevant ethical requirements;*
• *acceptance and continuation of client relationships, acceptance and execution of specific assignments;*
• *human resources;*
• *completing the task;*
• *monitoring*.

Management's responsibility for quality within the audit firm includes the establishment of policies and procedures to be applied by the company's employees, as well as the availability of certain experience and appropriate authority of managers.

The ethical principles of the quality control policy and procedures should ensure that the requirements are met, that auditors, responsible persons immediately report violations of the principle of independence or the quality control procedures themselves. At least once a year, the audit firm must receive written confirmation of the implementation of quality control policies and procedures related to the principle of independence from all employees of the firm who are concerned with the implementation of ethical principles. The explanatory materials specify that the fundamental principles to be followed are specified in the Code of Ethics, namely: honesty, objectivity, professional competence and appropriate attitude, confidentiality, professional behavior. To implement these principles there are necessary^

- ✓ *professional and competent management of an audit;*
- ✓ *the staff has appropriate education and continuous professional training;*
- ✓ *monitoring;*
- ✓ *establishment and implementation of quality control procedures.*

In accordance with the provisions of the Law on the Audit of Financial Statements of the Republic of Moldova, an auditor who has audited an entity for seven consecutive years may audit the same entity only two years after the last audit. [2]

In terms of accepting an offer or continuing a relationship with a client, the audit firm should develop policies and procedures for accepting the client's offer or continuing or terminating the relationship with him. These procedures should relate primarily to: the competence of the auditors and the ability to provide appropriate professional services to the client, the ability of auditors to comply with ethical principles and the client's principle of integrity. The fulfillment of the principle of integrity by the client presupposes the presence of his impeccable reputation, the risks associated with his field of activity; availability of information or indicators about the possibility of clients' involvement in money laundering or illegal actions; the reputation of the parties related to the client. In any case, the provisions of the standard require the audit firm to obtain the necessary information about the new client. In practice, situations may arise when the audit firm may refuse to perform services in this case, the policies and procedures established at the audit firm should provide for: discussions with the client's management about the current situation; discussion of the reasons for refusing to perform certain services. The audit firm must make sure that there is either a professional or a legal reason why it is necessary to refuse to provide services to the client.

The provisions of ISA 220 "Quality control in the audit of financial statements" pay great attention to the issues of ***human resources.*** At the same time, it is noted that an audit firm should develop a policy and procedures for quality control in terms of labor resources in order to ensure the hiring of specialists with a sufficiently high level of education, competence and experience, in order to comply with ethical principles, in order to provide professional services in accordance with technical standards and applicable regulations, as well as issue an appropriate audit opinion. The annexes of the explanatory material indicate that the following provisions concerning personnel should be developed in the quality control policy and procedures:

- ✓ *requirements for personnel when hiring them;*
- ✓ *evaluation of the work performed by the staff;*
- ✓ *the abilities of the staff, including the time required to complete the task;*
- ✓ *competence;*
- ✓ *professional development;*

- ✓ *wages and compensation, financial incentives for employees;*
- ✓ *taking into account the needs of the staff.*

The quality control policy and procedures in the ***performance of the task*** affect:

- ➢ *issues related to the implementation of the sequence of procedures in the performance of the mission;*
- ➢ *responsibility for supervision of the quality of work provided;*
- ➢ *responsibility for reviewing the work performed.*

The sequence of procedures for the provision of services or the performance of a mission should be standardized and documented either in instructions printed on paper or presented in electronic form; this information can also be contained in special computer programs. These procedures can be presented, for example: in the guide to the implementation of professional activities, or in special documents.

Audit methods and procedures should include the following:

●*ways of presenting the service and the essence of the mission, so that auditors understand the purpose of its implementation;*

●*a list of procedures to be followed to confirm that the services were provided in accordance with technical standards;*

●*the policy regarding the formation of the team of auditors, instructions for the implementation of work and supervision over the quality of their implementation;*

●*the methods used in the revision of the work performed, the significant judgments used and the form of the issued auditor's report;*

●*a list of necessary documentation for the services performed and its analysis;*

●*the procedures required to update the quality control policy.*

An important point in the process of providing professional services for audit firms is the process of documentation. The standard specifies that the audit firm must develop policies and procedures to maintain confidentiality, to ensure the safety of the auditor's documents. Confidentiality is maintained on a mandatory basis, except for cases when the client allows the disclosure of information, or it is provided for by law. At the same time, the legislation of each country may establish additional obligations for the audit firm in terms of compliance with the principle of confidentiality, especially with regard to the identification data of the client. As for the rules for storing documents, it is noted that audit documents can be in electronic form, filled in by hand, or in another form. Accordingly, the audit firm must ensure not only the safety of documents, but also the conditions under which they cannot be changed or supplemented with inappropriate information. To do this, it is necessary to provide access to documents only to authorized persons, to ensure the safety of information at all stages from the beginning of the provision of services to the final stage. If the documentation is in electronic form, then, accordingly, the authorized persons must have their own personal code that gives access to information. If the audit firm provides services and keeps records in electronic form, then if there are documents written by hand, they can be scanned and electronically archived and entered into the appropriate folder of the client. The storage periods for documents vary depending on the complexity, the nature of the services provided. In the local legislation of each country, their own terms of storage of documents may be established. In normal operation, the storage period for documents should not exceed 5 years from the date of submission of the auditor's report.

The audit firm should establish a ***monitoring process*** to provide reasonable assurance that the policies and procedures associated with the quality control system are relevant, adequate and operating effectively. This process should:

• include an ongoing assessment of the firm's quality control system, with the partner periodically reviewing the audit process or other services;

• delineate the responsibilities of partners who control the mission and monitor the quality of services rendered;

At least once a year, the audit firm must report to the responsible persons, for example: the board of directors of partners, including the executive director, on the results of the monitoring process.

The provisions of this standard also cover such issues as responsibility and taking action in case of complaints or conflict situations. Above all, the audit firm must create an atmosphere where auditors are unafraid to disclose the problems they are facing. Complaints may come from auditors, client representatives, or third parties. In any event, each case is reviewed and appropriate action taken, which may include improving quality control policies and procedures or applying appropriate action to those responsible for non-compliance with the policy. For audit firms that are small businesses, the requirement that the responsible persons who lead the mission and monitor the quality of the services provided must be different can be difficult to meet. In such cases, external independent consultants may be involved in handling complaints.

In any case, the monitoring process should be documented and include: the stages of selecting a specific mission to be monitored; verification of compliance with technical standards and legislation, verification of the quality control system and its effectiveness; disclosure of discovered deficiencies and development of proposals for improving the system. Small business auditing firms can use more simplified documentation, for example: documents can be completed by hand, such as checklists or other forms.

Analysis of quality management in conducting an audit of financial statements

Due to the importance of establishing quality control procedures at the level of an audit firm, and in particular when auditing financial statements, the International Auditing and Attestation Standards Board (IAASB) has modified ISA 220 Quality control in the audit of financial statements. The changes concerned primarily the name of the updated standard, the project is called ISA 220 " Quality management for an audit of financial statements".

The following table compares the structure of the two standards.

Table 1

Comparative characteristics of the structure of the ISA 220 "Quality control in the audit of financial statements" and the draft ISA 220 "Quality management for an audit of financial statements."

ISA 220 "Quality control in the audit of financial statements"	***ISA 220 "Quality management for an audit of financial statements."***
Introduction *Objective* *Quality control system and the role of audit teams* *Effective date* *Goal* *Definitions* *Requirements* *Manager's responsibility for audit quality* *Relevant ethical requirements*	*Introduction* *Effective Date* *Objective* *Definitions* *Requirements* *Leadership Responsibilities for Managing and Achieving Quality on Audits* *Relevant Ethical Requirements, Including Those Related to Independence*

Acceptance and continuation of client relationships, acceptance and fulfillment of certain tasks *Appointment of audit groups* *Completing a task* *Monitoring* *Documentation* *Application guide and other explanatory materials*	*Acceptance and Continuance of Client Relationships and Audit Engagements* *Engagement Resources* *Engagement Performance* *Monitoring and Remediation* *Documentation* *Taking Overall Responsibility for Managing and Achieving Quality* *Application and Other Explanatory Material*

Source: compiled by the author based on the provisions of ISA 220[1,3]

The audit firm should elaborate a policy or procedures that establish criteria for the performance of a quality controller:

- *Competence, opportunities, powers, restrictions on the right to work,*
- *Compliance with regulations, including ethical requirements,*
- *Responsibility for quality control, including refusal from the mission if the audit of financial statements has already started,*
- *The procedure for interaction with the head and the audit team,*
- *Identification of areas where the auditor's judgment has been applied,*
- *Consideration of key audit issues,*
- *Documentation (report, memorandum, audit team meeting, etc.).*

It should be noted that the quality management system of an audit firm should consist of the following 8 elements as amended in the ISA on quality management:

- *Governance and leadership;*
- *The firm's risk assessment process;*
- *Relevant ethical requirements;*
- *Acceptance and continuance of client relationships and specific engagements;*
- *Engagement performance;*
- *Resources;*
- *Information and communication; and*
- *The monitoring and remediation process.*

CONCLUSION

Analyzing the changes made to the provisions of the ISA 220"Quality control in the audit of financial statements", it can be stated that:

1) the provisions of the new standards establish two additional elements in the audit quality control system: this is the firm's risk assessment process and information and communication,
2) in connection with the introduction of such an element as risk assessment, in its quality policies and procedures, the audit firm should detect such risks and develop procedures to prevent them,
3) from the point of view of information and communication, the audit firm in its policies and procedures for quality control should develop a list of external and internal information flows and the employees of the audit firm should strictly adhere to the established rules in order to comply with them and observe the principle of confidentiality.

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