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ANALYSIS OF ISA PROVISIONS CONCERNING QUALITY MANAGEMENT FOR AN AUDIT OF FINANCIAL STATEMENTS

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Abstract: *Modern provisions concerning disclosure of information in financial statements, especially in extraordinary circumstances, dictate increased requirements for the quality of audit at the present stage. IAASB has developed draft changes to quality management standards for both the audit firm and the audit of financial statements. This article analyzes the provisions of changes in quality management standards in terms of management's responsibility for conducting audits, ethical requirements, including those related to independence, acceptance and continuation of relationships with clients, acceptance and performance of certain tasks, appointment of audit teams and documentation.*
Key words: *quality management, audit, financial statements.*

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INTRODUCTION

The requirements for a quality audit of financial statements are especially increasing in extraordinary circumstances. This is primarily due to the limitation of the scope of audit procedures or the wide access of the auditor to documentation or information, or to the client’s staff. This is especially true in a pandemic. In addition, in modern conditions, clients apply various variations of information technology (blockchain, artificial intelligence, automated analytical procedures, etc.).

Thus, situations arise in terms of audit quality control, which were not considered in the current International Auditing Standards, such as:

- ✓ *ISQC 1 «Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance and Related Services Engagements»,*

In this regard, the International Auditing and Assurance Standards Board (IAASB) has developed the following additions or draft regulations in terms of audit quality control, which should be adopted in September 2020:

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

ANALYSIS OF ISA PROVISIONS IN TERMS OF QUALITY MANAGEMENT

The following table shows the main provisions of the standard ISA 220, namely in the current version and revised.

Table 1. Comparison of the main provisions of ISA 220 in the current version and the revised version

ISA 220 Quality Control for an Audit of Financial Statements	**ISA 220*(revised) Quality Management for an Audit of Financial Statements***
Leadership Responsibilities for Quality on Audits Relevant Ethical Requirements Acceptance and Continuance of Client Relationships and Audit Engagements Assignment of Engagement Teams Engagement Performance Monitoring Documentation	Applying, and Complying with, Relevant Requirements System of 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 Monitoring and Remediation Process Network Requirements or Network Services Service Providers Documentation

Source: Compiled by the author on the basis of ISA 220

ISA 220 (revised) Quality Management for an Audit of Financial Statements sets that the audit team, when conducting an audit, should determine whether and implement the response measures other than those set out in the audit firm's quality control policies and procedures.

In this case, the response measures (in relation to the quality management system) these are developed policies or procedures implemented by an audit firm to eliminate quality risk:

- ✓ *a policy is a statement of what should or should not be done to eliminate quality risk. Such statements may be documented, explicitly stated in communications, or implied through actions and decisions.*
- ✓ *procedures are actions to implement the policy.*

Before issuing an audit report, the engagement partner must determine whether the audit is in compliance with ethical standards.

In terms of independence, ISA 220 (revised) "Quality Management for an Audit of Financial Statements" establishes:

- ✓ *creating guidelines containing relevant ethical requirements and recommendations on how they are applied in the course of an audit,*
- ✓ *develop policies or procedures for staff to communicate relevant information during the audit,*
- ✓ *creating an information system, including using it applications (i.e. resources), to monitor compliance with relevant ethical requirements, including registering and maintaining information about independence.*

The engagement partner is required to establish that the members of the audit team have conducted appropriate consultations in the course of performing the audit, within the group. At the same time, the standard prohibits issuing an audit opinion until quality control is completed (where this is provided by the standards).

The Revised ISA 220 introduces a new paragraph 34, "Differences of opinion", which states that if there are different opinions in the team on certain issues or between them and the, the provisions for getting out of this situation should be reflected in the quality control procedures of the audit firm. However, the engagement partner cannot issue an audit report until all differences of opinion have been resolved.

Practical example: when conducting an audit of the financial statements of a construction company, the client's accounting registers reflect construction in progress for one of the company's divisions. The client provides the auditors with all the documentation, but refuses to allow the auditors to conduct an stock taking at this division. The auditors ' opinions on this issue are divided.

Solution: In this situation, the auditors must perform additional procedures, namely: first of all, check the balance and accounting records for the construction in progress account, to determine if this balance is significant for the financial statements as a whole. However, limiting the scope of the audit will affect the auditor's opinion, depending on the size of the balance and its materiality, and not allowing auditors to stock taking the construction in progress should lead to the expression of a modified audit opinion.

ISA 220 (revised) Quality Management for an Audit of Financial Statements establishes that the quality management system of an audit firm consists of the following 8 elements:

- *Management and leadership;*
- *The firm's risk assessment process;*
- *Relevant ethical requirements;*
- *Acceptance and continuation of client relationships and specific;*
- *Resources;*
- *Information and communication; and*
- *Monitoring.*

It should be noted that ISA 220 (revised) Quality Management for an Audit of Financial Statements states that if the previous auditor refused to perform the audit as a result of identified or suspected non-compliance with laws and regulations, the IESBA code requires that the predecessor auditor provide all necessary information to the successor auditor so that the he can make a decision to conduct the audit.

An important point is the fact that ISQM 1 "Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements" expands the concept of resources to include:

- ✓ *Human resources;*
- ✓ *Technological resources; and*
- ✓ *Intellectual resources.*

Previously, the ISA 220 Quality Control for an Audit of Financial Statements addressed only human resources.

ISA 220(revised) Quality Management for an Audit of Financial Statements specifies that a firm's quality control policies and procedures may contain specific requirements related to:

- *The nature, timing and scope of the documentation to be checked:*

- *Different types of reviews that may be relevant in different situations (for example, a detailed review of each individual working document); and*
- *Which auditors -members of the working group should perform various types of audit procedures.*

The engagement partner applies his judgment in the following cases:

- *audit planning,*
- *the risk assessment process,*
- *transactions with related parties,*
- *planning an audit of a group of companies,*
- *the effect of uncorrected misstatements on the financial statements,*
- *type of audit opinion.*
- *decisions on conducting an audit of consolidated financial statements*

It should be noted that it is neither necessary nor practical for the auditor to document each issue considered or professional judgment made during the audit of financial statements, for example:

- *The activities of the audit team can be documented by signing the audit plan,*
- *results of meetings of members of the audit team may indicate clarity, consistency in conducting an audit,*
- *The signatures of the auditors and the engagement partner on the working documents provide evidence that they have been compiled and verified.*

An important point in terms of quality control may be issues that need to be taken into account in extraordinary circumstances (a pandemic), the following are examples of events that may be relevant to study in such circumstances:

- ✓ *new agreements, guarantees, obligations related to the pandemic,*
- ✓ *current or planned asset purchases as a result of the pandemic,*
- ✓ *capital increase or issue of debt instruments, such as the issue of new shares or debt obligations, or an agreement to merge or liquidate,*
- ✓ *preferential or incentive economic payments provided by the government in the form of loans or grants,*
- ✓ *any changes related to contingent liabilities (for example, new contingent liabilities or circumstances affecting the assessment of existing contingent liabilities, the ability to meet agreed performance targets for contingent consideration in a business combination, etc.)*
- ✓ *any unusual accounting adjustments,*
- ✓ *any events that cast doubt on the accuracy of the accounting policies used in the financial statements,*
- ✓ *statements (for example, events that cast doubt on the validity of the going concern assumption),*
- ✓ *any event relevant to an accounting estimate or the establishment of reserves,*
- ✓ *derivative financial instruments and hedging considerations,*
- ✓ *agreements with customers or suppliers, variable remuneration, commission accrual, etc.)*
- ✓ *any events related to asset recoverability*
- ✓ *modification of existing contractual agreements (for example, reduction or deferral of lease payments made by the lessor to the lessee, changes in the terms of debt, etc),*
- ✓ *tax considerations (for example, the impact of reduced flow of goods and services on transfer pricing agreements; recoverability of deferred tax assets)*

- ✓ *benefits for the dismissal of employees as a result of a reduction in labor force (for example, as a result of closure or reorganization of operations that occurred after the reporting date).*

The auditor uses skepticism and can carry out additional procedures for events after the reporting date, to client events such as:

- ➢ *Loss of a large market, key customers, sharp decrease in revenue, shortage of labor,*
- ➢ *Significant change in the value of assets (long-term) used to generate cash flows,*
- ➢ *Significant change in the value of current assets (inventory,)*
- ➢ *Delay in the release of new products or services, or the sale of new products,*
- ➢ *Fluctuations in the exchange rate,*
- ➢ *Measurements affected by increasing uncertainty,*
- ➢ *Credit risk,*
- ➢ *Solvency of the enterprise.*

At the stage of making a decision on the auditor's opinion, the auditor should assess the possibility of operating the enterprise in the future for a period of one year, but in extraordinary circumstances (a pandemic), this period may be extended.

At the same time, if facts have been established that may cast significant doubt on the company's operations in the future, the auditor should conduct additional audit procedures. In addition, the auditor should consider:

- ✓ *development and implement management measures and processes so that the enterprise can continue to operate in an efficient environment,*
- ✓ *measures to provide management with reliable and up-to-date information on an ongoing basis to manage future operations, including, for example, the flow of financial information from branches and divisions.*

After conducting an audit in accordance with quality control requirements, the engagement partner decides on the auditor's opinion on the financial statements.

The following are types of audit opinion:

1. the financial statements are materially misstated (significantly, but not universally) - modified opinion,
2. the financial statements are materially misstated (materially, and universally)- adverse opinion,
3. inability to obtain sufficient and reliable audit evidence (significantly, but not universally) - modified opinion,
4. inability to obtain sufficient and reliable audit evidence (substantially and universally)- refuse to express an opinion.

CONCLUSIONS

Analyzing the draft revised quality standards:

- ➢ ISA 220 (revised) Quality Management for an Audit of Financial Statements and
- ➢ International Standard on Quality Management 1 (Revised) Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements and

and also epy International Standard on Quality Management 2 (Proposed) Engagement Quality Reviews, we can emphasize the following:

1) audit firms will need to review and modify their quality management policies and procedures at the firm level,

2) audit firms will need to review and modify their quality management policies and procedures on the audit mission,
3) when conducting an audit, it is necessary to consider resources from the point of view not only human, but also technological and intellectual resources,
4) greater attention should be paid to the audit procedures for checking the principle of going concern and subsequent events after the financial statements.

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