

## Client Acceptance and Continuance



**International Federation  
of Accountants**

Forum of Firms  
International Federation of Accountants  
545 Fifth Avenue, 14<sup>th</sup> Floor  
New York, New York 10017 USA

The mission of IFAC is to serve the public interest, strengthen the worldwide accountancy profession and contribute to the development of strong international economies by establishing and promoting adherence to high quality professional standards, furthering the international convergence of such standards and speaking out on public interest issues where the profession's expertise is most relevant.

The objective of the Forum of Firms is to promote consistent and high quality standards of financial reporting and auditing practices world-wide.

Members in the Forum<sup>1</sup> have committed to adhere to and promote the consistent application of high quality audit practices worldwide, including the use of International Standards on Auditing, and the maintenance of appropriate quality control standards in accordance with International Standards on Quality Control issued by the International Auditing and Assurance Standards Board. Through their organizations, members also conduct globally coordinated internal quality assurance reviews on a regular basis and have policies and methodologies which conform to the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code).

The Transnational Auditors Committee is the executive committee of the Forum of Firms. Further information about both can be located at [http://ifac.org/Forum\\_of\\_Firms/](http://ifac.org/Forum_of_Firms/).

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<sup>1</sup> See Appendix 2 for a listing of Full members as of January 1, 2010.

**TRANSNATIONAL AUDITORS COMMITTEE**  
**GOOD PRACTICE GUIDANCE**  
**CLIENT ACCEPTANCE AND CONTINUANCE**

**CONTENTS**

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	Page
Background .....	4
Introduction .....	5
Approach .....	6
1. Client Acceptance .....	7
A. Determining the Integrity of the Prospective Client .....	7
B. Determining Competency of the Firm to Perform the Engagement .....	17
C. Compliance with Ethical Requirements .....	20
D. Additional Considerations with Client Acceptance .....	25
2. Client Continuance .....	28
Appendix 1: External Inspection Reports Reviewed .....	32
Appendix 2: Full Members of the Forum of Firms (as of January 1, 2010) .....	33
Appendix 3: Comparison of Client Acceptance and Continuance Requirements .....	34
Appendix 4: Obligations of Membership to the Forum of Firms .....	38
Appendix 5: Requirements of ISA 220, <i>Quality Control for an Audit of Financial Statements</i> , and ISA 600 <i>Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)</i> .....	39
Appendix 6: Guidance in A19 of ISQC 1 .....	40
Appendix 7: Guidance in A18 of ISQC 1 .....	41

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## Background

Delivery of high quality services is the driver of success for all professional services firms. Quality service is important to maintaining client satisfaction, delivering value for money and establishing professional reputation. For professional accountancy firms<sup>2</sup> (and audit firms in particular), delivering quality service is at the core of the business strategy, and is essential to satisfy the public interest responsibilities of professional accountants.

As part of its ongoing work program, the Transnational Auditors Committee (TAC) regularly reviews the inspection reports published by external audit oversight boards and regulators. The objective of this review is to identify findings common across jurisdictions and to evaluate whether additional guidance would benefit the members of the Forum of Firms.

One of the issues highlighted in recent reviews of these reports (two reviews were performed – in 2008 and 2009)<sup>3</sup> related to audit firms' and their performance of "client acceptance and continuance" procedures. The reviews' findings with respect to client acceptance and continuance included, among other things, matters related to the completeness of documentation, timeliness of performance of acceptance and continuance considerations and audit team competency.

Both in response to this and the key role well-developed client acceptance or continuance procedures play in the overall quality of an audit, the TAC has undertaken to explore current practice among members of the Forum of Firms. This good practice paper has been prepared based on the input of 14 Forum members, representing international networks of varying sizes. Where necessary, Forum members granted interviews and supplied background materials which have been summarized in this paper on a non-attributed basis.

The TAC believes this paper will be a valuable tool for audit firms of all sizes, in developing and evolving their policies on client acceptance and continuance, thereby demonstrating their ongoing commitment to enhancing audit quality.

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<sup>2</sup> Due to the variety of sources used to compile this paper, a number of different terms are used to describe the relevant organization. There is no intent to be either consistent or prescriptive in the usage of terms such as Firms, members, networks, organizations, etc. Such terms should be interpreted in their customary meaning and in the particular context.

<sup>3</sup> See Appendix 1 for the listing of External Inspection Reports.

## Introduction

### Why are client acceptance and continuance policies and procedures so important and relevant to audit firms?

As discussed in a publication issued by the TAC entitled *Tone at the Top and Audit Quality*,

Firms note that quality is viewed as a requirement in everything that they do. Notably, quality is identified as being an essential component of a firm's reputation and a prerequisite for a firm's survival and growth.<sup>4</sup>

As further noted in the same publication:

Firms expect the same commitment to quality and integrity on the part of their clients as they do of themselves. As a result, many firms have developed and implemented enhanced processes for reviewing and approving new clients as well as reviewing relationships with existing clients. Several firms state that they will and have resigned from a client when the client does not meet the firm's high standards, or when the firm cannot commit sufficient resources to deliver quality services to the client.<sup>5</sup>

From an audit engagement perspective, the absence of a genuine joint commitment to optimal quality can lead to difficult auditor-client relationships, severe damage to the firm's professional reputation and the profession generally and ultimately to a loss of public confidence. Possessing as much information as necessary to make an informed assessment about the acceptability of the potential client and the ability of the audit firm to perform a quality audit helps ensure the relationship is as beneficial as can be—for both the auditor and the client. Bottom line, it's just makes good sense.

As noted in a publication from the American Institute of Certified Public Accountants:

Prudent risk management requires that a firm know as much as possible about what will be involved with a new client relationship or engagement before the agreement is in place. Not having made a diligent risk assessment by performing timely client and engagement acceptance procedures almost guarantees that surprises will follow. And, the result may not only involve an unplanned relationship termination but could also include significant professional liability issues and concerns.<sup>6</sup>

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<sup>4</sup> Transnational Auditors Committee, *Tone at the Top and Audit Quality*, December 2007, Page 10

<sup>5</sup> Ibid, page 12

<sup>6</sup> McFadden, John E, *Client and Engagement Acceptance: Only a Public Company Audit Service Concern?* The Practicing CPA, July-August 2003, Volume 27, Number 6

## Approach

There are several standards published by the International Auditing and Assurance Standards Board (IAASB) which address client acceptance and continuance. These are:

- International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance, and Related Services Engagements*,<sup>7</sup> and
- International Standard on Auditing 220, *Quality Control for an Audit of Financial Statements*

Further, with respect to the audits of group financial statements, the IAASB has issued:

- International Standard on Auditing 600: *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*.

Members of the Forum of Firms have committed<sup>8</sup> to maintaining appropriate quality control standards in accordance with ISQC 1 and, through their commitment to having policies that comply with the ISAs, in accordance with ISA 220 and 600. The latter standards address acceptance and continuance requirements at the engagement level rather than the firm level, but of course those requirements fit within the firm's overall quality control processes. As such, for convenience, the requirements particularly of ISQC 1<sup>9</sup> provide much of the structure in this paper. ISQC 1 states:

26. The firm shall establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide the firm with reasonable assurance that it will only undertake or continue relationships and engagements where the firm:
  - (a) Is competent to perform the engagement and has the capabilities, including time and resources, to do so; (Ref: Para. A18, A23)
  - (b) Can comply with relevant ethical requirements; and
  - (c) Has considered the integrity of the client, and does not have information that would lead it to conclude that the client lacks integrity. (Ref: Para. A19-A20, A23)
27. Such policies and procedures shall require:
  - (a) The firm to obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. (Ref: Para. A21, A23)
  - (b) If a potential conflict of interest is identified in accepting an engagement from a new or an existing client, the firm to determine whether it is appropriate to accept the engagement.
  - (c) If issues have been identified, and the firm decides to accept or continue the client relationship or a specific engagement, the firm to document how the issues were resolved.

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<sup>7</sup> ISQC 1, effective December 15, 2009 (clarified ISQC 1) will be referred to throughout this document, given that upon publication of this paper this will be the version to be complied with. At the time this paper was developed participating networks were at differing stages of implementing clarified ISQC 1 into their methodologies. However, given that the client acceptance and continuance dispositions of the clarified ISQC 1 are identical to those in the extant version, other than for the adoption of the clarity conventions, it is felt that this has no impact on the appropriateness of the material presented in this paper (see appendix 3 for a comparison). For the purposes of this paper, clarified ISQC 1 has been used as the basis for this paper's format, references and consideration of materials provided by participating networks.

<sup>8</sup> See Appendix 4 for the Forum of Firm's membership obligations.

<sup>9</sup> See Appendix 5 for the requirements of ISA 220 and 600.

28. The firm shall establish policies and procedures on continuing an engagement and the client relationship, addressing the circumstances where the firm obtains information that would have caused it to decline the engagement had that information been available earlier. Such policies and procedures shall include consideration of:
- (a) The professional and legal responsibilities that apply to the circumstances, including whether there is a requirement for the firm to report to the person or persons who made the appointment or, in some cases, to regulatory authorities; and
  - (b) The possibility of withdrawing from the engagement or from both the engagement and the client relationship. (Ref: Para. A22-23)

## 1. Client Acceptance

### A. Determining the Integrity of the Prospective Client

ISQC 1's paragraph 26(c) notes the need for considering the integrity of the client, and that the firm does not have information that would lead it to conclude that the client lacks integrity. While considering client integrity was not noted as a general issue in the TAC's review of inspection reports, one oversight body (Canada) did raise some specific recommendations about the need for the performance and documentation of an assessment of management and board integrity and reputation. Further, another recommendation was the need to develop policies for communicating with predecessor auditors to ascertain whether there are circumstances the firm should take into account in deciding whether to accept the engagement.

In reviewing the practices and procedures of participating networks for this paper, it was highlighted in one network's policies that "The personal characteristics, philosophy and operating style of the individuals who comprise an entity's management have a significant influence on the entity as a whole. The integrity of management and principal owners of an entity is fundamental to the Member Firm's ability to provide professional services and is a key consideration in the assessment of client risk and, thus, Engagement Risk."

Further, "If the Member Firm has reason to question the integrity of the management or principal owners of a prospective or existing Client and they do not meet an acceptable standard of integrity, the Member Firm would ordinarily not accept or continue to be associated with the entity, because the Engagement Risk would be increased beyond an acceptable limit."

These sentiments are representative of the theme throughout all the policies considered in relation to client integrity. As such, of the 14 networks reviewed, policies and procedures relating to client integrity (and related to this, the client's industry and operating environment) receive the greatest degree of focus in forming a conclusion on whether or not to accept or continue with a client. However, the volume of emphasis and extent of the policies and procedures associated with establishing client integrity varies considerably across the networks reviewed principally as a function of size.

It is worth noting that ISQC 1 paragraphs A19-A20 and A23 (A23 focuses on the public sector<sup>10</sup>) discusses guidance in support of 26(c) of ISQC 1—providing further potentially useful material

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<sup>10</sup> A23 states: In the public sector, auditors may be appointed in accordance with statutory procedures. Accordingly, certain of the requirements and considerations regarding the acceptance and continuance of client relationships and specific engagements as set out paragraphs 26-28 and A18-A22 may not be relevant. Nonetheless, establishing

for networks when considering their related policies and procedures. To varying degrees, the networks reviewed do pick up on the themes listed within A19<sup>11</sup> (A20 discussed later).

The illustrative checklist below presents an overall aggregation of questions and matters considered by the networks<sup>12</sup> reviewed to assist them in their determination of client integrity.<sup>13</sup> While mentioned in the checklist below, it should be noted that firms in some jurisdictions are required to implement extensive procedures to deal with regulations relating to e.g. money laundering, which is also relevant in the context of “knowing the client” and client acceptance and continuance.

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policies and procedures as described may provide valuable information to public sector auditors in performing risk assessments and in carrying out reporting responsibilities.

<sup>11</sup> See Appendix 6 for the contents of A19.

<sup>12</sup> In the case of small and medium size practices and clients a reduced checklist could be used to ensure a cost effective approach that covers all the requirements of the ISAs and ISQC 1.

<sup>13</sup> As can be seen, certain questions and matters in the checklist relate to general risk management concerns (possibility of a public offering, reliance on other auditors, financial and going concern considerations, etc.) rather than being specifically related to client integrity. We have chosen to include these questions since, although they may not respond to specific requirements of ISQC 1 or ISAs, they are clearly matters which Firms need to address in deciding whether to accept an engagement and, if present, they would certainly have an impact on audit planning activities. However, it is not the purpose of this paper to address risk management policies and procedures in other respects.

General Information	Response	
<p>Provide information regarding:</p> <ul style="list-style-type: none"> <li>• Which Country is the ultimate parent company registered in?</li> <li>• Location(s) of entity operations</li> <li>• Industry</li> <li>• Key governance/management of the entity                             <ul style="list-style-type: none"> <li>○ CEO</li> <li>○ CFO</li> <li>○ Other</li> </ul> </li> <li>• Lawyers</li> <li>• Bankers</li> <li>• Previous Auditor</li> </ul>		
<p>Entity Financial Information</p> <ul style="list-style-type: none"> <li>• Total Assets</li> <li>• Current Liabilities</li> <li>• Long Term Liabilities</li> <li>• Working Capital</li> <li>• Equity</li> <li>• Cash Flows from Operations</li> <li>• Revenue</li> <li>• Net Income</li> </ul>	X1	X0
<p>What accounting standards are to be applied to the engagement (international, domestic, other)?</p>		
<p>What auditing standards are to be applied to the engagement (international, domestic, other)?</p>		

CLIENT ACCEPTANCE AND CONTINUANCE

	Yes/ No	<b>Other relevant information.</b> A “Yes” response in particular should be further explained—where applicable supported by how the risk is to be mitigated to an acceptable level
<p>Are there any planned transactions within the next year in which the engagement results may be used:</p> <ul style="list-style-type: none"> <li>• Any Initial Public Offering of any form of securities in any markets?</li> <li>• Private offering of any form of securities in cross-border markets?</li> <li>• Other private transaction where a duty-of-care is expected to be established?</li> <li>• Sale or merger of the entity/net assets?</li> </ul>		
<p>Will there be reliance on the work of other auditors for a substantial portion of the engagement?</p>		
<p>Will the other auditor be a non-Network Firm?</p>		
<p>Will the other Firm be registered with a regulatory body?</p>		
<p><b>Identity and Business Reputation of the Client’s Principal Owners, Key Management, and Those Charged with its Governance</b></p>		
<p>Do we have any concerns identifying ownership, key management or those charged with governance?</p>		
<p>Is there domination of key management by one/few individuals?</p>		
<p>Do we have concerns regarding management’s competence? Matters to consider include:</p> <ul style="list-style-type: none"> <li>• Experience</li> <li>• Skill (e.g.: effective budget preparation and monitoring)</li> <li>• Depth</li> <li>• Background (e.g.: criminal convictions)</li> </ul>		

<b>Identity and Business Reputation of the Client’s Principal Owners, Key Management, and Those Charged with its Governance</b>		
Does management have an unhealthy tolerance for business risk?		
Are there any personality profiles within the management which cast a doubt on integrity/pose an audit risk?		
Does management’s attitude towards financial performance and business management cause a concern?		
Are there any expected changes in ownership, key management or those charged with governance that give doubt to integrity?		
Are there any overall concerns with the integrity or business reputation of the management or those charged with governance?		
Do we have concerns that management does not foster and are not supportive of an ethical business culture?		
<b>Financial and Going Concern Considerations</b>		
<p>Do we have any concerns with the financial condition of the entity—consideration includes:</p> <ul style="list-style-type: none"> <li>• Financial statement analysis</li> <li>• Profitability margins and their consistency</li> <li>• Debt covenants / credit ratings</li> <li>• Dependence upon an important project, contract, or new business model or concept</li> <li>• Products (current and planned) and services of the entity/industry—market presence and growth— stability of industry—nature of industry (litigious)—extent of any regulatory oversight</li> <li>• Regulators—status of regulatory filings —relations with regulatory authorities</li> </ul>		

<b>Financial and Going Concern Considerations</b>		
<ul style="list-style-type: none"> <li>• Supplier/customer concentration Planning for any significant mergers/acquisitions/disposals/financing</li> <li>• Entity intentions re offering debt or equity securities</li> <li>• Amount of publicly traded debt outstanding—trading value compared to face value</li> <li>• Listed share price of the entity</li> <li>• Sensitivity of entity assets to market conditions</li> <li>• Expiration or violations of licenses or permits</li> <li>• Presence of off balance sheet financing structures or similar</li> <li>• Other</li> </ul>		
<b>Nature of Client Operations</b>		
Does the complexity of the entity structure provide us with any cause for concern (e.g.: is the structure seemingly unnecessarily complex, off-shore banking arrangements which seem unnecessary)?		
Do the entity operations involve tax complexities?		
Is the entity the subsidiary of a public company or a significant subsidiary?		
Is the entity an SEC Registrant or about to become one?		
Does the entity operate in a specialist legal or regulatory environment?		
Does the media portrayal of the entity/management cause concern with respect to the client’s integrity?		
Was/is the entity involved in any past, current or impending significant litigation?		

<b>Attitude Towards Aggressive Interpretation of Accounting Standards and the Internal Control Environment</b>		
Is there an attitude towards aggressive interpretation of accounting standards (e.g.: revenue recognition)?		
Is there a concerning attitude towards the internal control environment (or its improvement)?		
Is there a history of a lack of reliability of past accounting estimates by management (possibly resulting in disputes with past auditors)?		
Does management propose accounting policies or treatment of specific transactions which cast a doubt on their integrity?		
Do we have any concerns about attitudes within the entity that controls are unimportant or should be circumvented?		
Do we have any concerns that management turnover has had a negative impact on the internal control environment?		
Are there indications of the ineffectiveness of the Chief Financial Officer in enforcing controls or ineffectiveness of the internal control environment generally?		
<b>Payment of Fees</b>		
Have there been any concerns over management's ability and willingness to pay for professional services rendered in the last year?		
<b>Scope Limitation</b>		
Is there any indication of an inappropriate limitation in the scope of work/access to records?		
<b>Money Laundering or Other Criminal Activities</b>		
Is the entity operating in an industry or sector which has an exposure to fraud or illegal acts?		

CLIENT ACCEPTANCE AND CONTINUANCE

<b>Money Laundering or Other Criminal Activities</b>		
Does the mode of the client's operations or business practices cast doubt on its integrity?		
<b>Reason for Proposed Appointment/ Non-Reappointment of the Previous Firm</b>		
Have our dealings with the predecessor auditor raised any concerns?		
Have the quality of any of our dealings with the predecessor auditor raised any concerns?		
Is there any concerning reason(s) why the previous auditors have not been re-appointed?		Why have not been re-appointed?
Are there matters for concern in prior year(s) audit report?		
Has there been a frequency of changing auditors?		
Was the manner in which we were introduced to the entity a matter of concern?		How were we introduced?
Have other Firms refused to provide services to this entity?		
Do we have any history of disputes dealing with the entity?		
<b>Identity and Business Reputation of Related Parties</b>		
Do we have any concerns with related party transactions outside the ordinary course of business?		
Does the complexity of related party transactions give concern with respect to integrity?		

Overall Assessment

Does the integrity of the entity, its principal owners, key management, or those charged with its governance create an unacceptable risk?	
Please rate the client risk?	
(Where applicable) Does the Firm’s Risk Specialist agree with plans to reduce risks to an acceptable level? (document in the working file)	

Having access to sufficient sources of information or most appropriate persons within the entity to enable a thorough assessment

Full and open access to key personnel and information within the prospective client is desirable to enable gaining necessary client knowledge and aiding an assessment of the client’s/management integrity. To assist in this respect, the Networks provided some practical insights, as follows:

- Access to all the relevant resources within a potential client to enable a thorough assessment can never be guaranteed for every engagement being considered. However, the onus is on the Firm to maximize their contact with the prospective client in order to obtain as much information as possible.
- The critical nature of these assessments in the context of overall risk management should be emphasized. Getting to know and better understand the client is a key component of the assessment and one that generally also enables the provision of a higher quality service by the Network. As such, it is mutually beneficial for the entity to be as open and transparent as possible about itself and its operations.
- One Network highlighted that an indication that the client is not willingly providing information to assist with the assessment could be viewed as an indicator of higher risk. Dependent upon the nature of the entity’s actions, this may justify engaging the advice and guidance of the Firm’s risk management specialists.
- Many of the Networks highlighted that there are numerous avenues open to the auditor beyond direct client contact to enable the assessment to be made and that these could be pursued in support of (and to verify) representations made by the entity. Discussions with the prior auditor, lawyers, and other service providers as well as researching publicly available information are all avenues that could be pursued (further discussion provided below). Related to this is the use of in-house or third party research and investigation services to assist in performing background checks and seeking credible evidence to corroborate other aspects of an informed assessment.

Sources of information to assist in determining client integrity

Paragraph A20 of ISQC 1 provides the following guidance on sources of information that could be used to assist the Firm in performing an assessment as to client integrity.

- Communications with existing or previous providers of professional accountancy services to the client in accordance with relevant ethical requirements, and discussions with other third parties.
- Inquiry of other Firm personnel or third parties such as bankers, legal counsel and industry peers.
- Background searches of relevant databases.

These suggested sources are, not surprisingly, referenced by most of the Networks reviewed. One Network notes however that, in relation to the performance of background checks, this may be of a sensitive nature in some jurisdictions. As such each Firm should establish policies and guidance for (1) the collection and confidentiality of background information obtained in performing the checks and (2) the documentation and retention of such information. Each Firm should establish that the policies and procedures comply with local laws.

Networks note that background checks may be performed using both publicly available information sources and non-publicly available information sources, as appropriate. The extent of the procedures performed and data obtained will depend on the specific circumstances of the entity (e.g., public interest entities versus nonpublic interest entities) and the regulatory and legal environment in which the check is to be performed but could also include one or more of the following:

- Information obtained from sources inside the Firm:
  - Audit partner knowledge of the entity and its Principal Officers/Owners based on prior professional or personal relationships
  - Discussions with Partners within the Firm who have had professional or personal experiences with the entity and its Principal Officers/Owners
- Information obtained from sources external to the Firm:
  - Inquiries of third parties who may have knowledge of the individuals and/or entities. Third parties could include individuals in the business community, lawyers, bankers, industry leaders, or others.
  - Searches of the following:
    - Public databases
    - Regulatory filings
    - Newspapers
    - Published articles
    - Keyword internet searches
  - Inquiries performed by outside investigative agencies or credit agencies.

Finally, in forming an assessment as to client integrity, paragraph A20 notes:

The extent of knowledge a Firm will have regarding the integrity of a client will generally grow within the context of an ongoing relationship with that client.

We will see later that such knowledge is consequently a key element in the context of client continuance decisions.

## B. *Determining Competency of the Firm to Perform the Engagement*

While paragraph 26(c) focuses on determining client integrity, paragraph 26(a) of ISQC 1 focuses on the need for the Firm to ensure it is in fact competent to perform the engagement in the first place and has the capabilities, including time and resources, to do so. The need to have the necessary competence under paragraph 26(a) is supported by paragraph A18<sup>14</sup> providing further guidance which Networks could find useful in considering their policies and procedures as they relate to competence.

The TAC's review of external inspection reports did note a couple of issues specifically related to determining competency. One finding (more in relation to continuance) was that a few Firms were not assessing whether they have the language capability to perform an audit when key evidence is in a foreign language. A further recommendation was to require an assessment of whether the Firm/engagement team has the necessary linguistic skills and that additional training be provided on the need to consider and document whether the engagement team has the requisite skills to conduct the engagement.

Key to enabling a meaningful determination of the Network's competency is a thorough understanding of the entity and its industry. As such, a necessary component of "competency" considerations are questions associated with "knowledge of the client," which can be noted in several of the questions used in the illustrative checklist to assist in determining client integrity. Indicators that extra consideration needs to be given to the competencies within the Network to perform the engagement to the necessary quality are as follows:

- Complexity of the entity's structure
- Complexity of the entity's transactions, or transactions for which the related accounting is complex, "emerging" or subject to significant professional judgment/interpretation
- Entity involvement with off-shore transactions
- Complex tax arrangements
- Entities operating within specialized industries such as banking/finance/insurance, real estate/construction, gaming/gambling, government/public sector enterprises, leasing, agriculture, etc.
- An entity which is (or is a significant component of) a public interest entity

Armed with a solid foundation of "client knowledge," the Networks reviewed asked questions in the following areas to further determine their competency to undertake the engagement—again, as with client integrity, presented as an illustrative checklist.

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<sup>14</sup> See Appendix 7 for the guidance in A18 of ISQC 1.

CLIENT ACCEPTANCE AND CONTINUANCE

Competence to Perform the Engagement	Response	
Indicate the number of years of experience the engagement partner has in the entity’s industry.		
Is this engagement subject to partner rotation requirements?		
Indicate the number of years of experience the engagement manager has in the entity’s industry.		
	Yes/ No	<b>Other relevant information. A “Yes” response in particular should be further explained—where applicable supported by how the risk is to be mitigated to an acceptable level</b>
<p>Does the entity have operations in any of the following high risk industries or portfolios?</p> <ul style="list-style-type: none"> <li>• Banks, financial institutions</li> <li>• Insurance providers</li> <li>• Mutual funds</li> <li>• Gambling/gaming</li> <li>• Brokers/dealers</li> <li>• Real estate/construction</li> <li>• Leasing</li> <li>• Public sector not-for-profit</li> <li>• High litigation industries</li> <li>• Software development</li> <li>• Sport franchises</li> <li>• Businesses with going concern issues</li> </ul>		
Does the entity recognize revenue applying complex or evolving accounting conventions?		
<p>Does the entity have significant activities related to any of the following areas:</p> <ul style="list-style-type: none"> <li>• Acquisition accounting</li> </ul>		

Competence to Perform the Engagement	Response	
<ul style="list-style-type: none"> <li>• Reorganization</li> <li>• Restructuring charges</li> <li>• Self-insurance</li> <li>• Use of derivatives</li> <li>• Debt covenants</li> <li>• Other</li> </ul>		
<p>Will the engagement require the use of work of experts?</p>		
<p>Are there any concerns regarding the <b>availability</b> of professional staff to enable completion of the engagement to a both a quality standard and in a timely manner?</p>		
<p>Are there any concerns regarding the partner and staff having <b>sufficient knowledge and experience</b> for the engagement?</p>		
<p>Are there any matters related to staffing the engagement which would indicate that the engagement should not be accepted or why such acceptance needs to be considered by a second partner or head of specialization?</p>		
<p>Are any special licenses or permits or approvals required for our staff to carry-out the engagement in the jurisdiction where the work will be performed?</p>		

Overall Assessment

<p>Does the engagement team, including appropriate industry and specialty experts who will be part of the team, have the relevant experience and competence and sufficient available time to:</p> <ul style="list-style-type: none"> <li>• Address the primary and other industries noted above?</li> <li>• Address any risks or issues noted in the above?</li> <li>• Reduce any competency risks associated with the engagement to an acceptable level?</li> </ul>		
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## Reducing risks associated with competency and performance

As alluded to above, various facets of the structure, transactions, or industry of a potential client can pose challenges to the adequacy of competencies within the Firm, often requiring the need to further consult specialists or others within the Firm hierarchy (discussed further later).

A common theme noted by the Networks reviewed is an emphasis on the importance of audit quality per se. As one Network puts it “The best way to control factors related to performance is by adopting and applying the highest technical standards, policies, and procedures; assigning appropriate, competent, and properly trained personnel; encouraging consultation; and establishing strong review and approval procedures.”

However, the Networks acknowledge that the risk of being exposed to criticism and negative publicity associated with the adequacy and quality of professional services cannot be completely eliminated. Factors which may contribute to reduced exposure to this risk include:

- Diligent investigation of the background and reputation of the potential client;
- Avoiding engagements that involve undue risks;
- Clearly establishing the terms of engagement and setting out unambiguous, achievable terms of reference;
- Applying a sound audit methodology; and
- Sensitivity to clients’ and users’ perception of the Firm’s performance.

### C. *Compliance with Ethical Requirements*

Paragraph 26(b) of ISQC 1 requires that the Firm have policies and procedures to ensure compliance with relevant ethical requirements. This is supported by further extensive discussion within ISQC 1, notably paragraphs 20–25 which is further supported by explanatory paragraphs A7–A17. The explanatory paragraphs outline the key principles and tenets of the International Ethics Standards Board for Accountants’ Code of Ethics (IESBA Code):<sup>15</sup>

- Integrity
- Objectivity
- Professional Competence and Due Care
- Confidentiality
- Professional Behavior

Ethical requirements, and more specifically, independence, was an issue noted in the TAC’s review of inspection reports. One comment noted the general lack of rigor in some of the Firms which included failing to consult personnel prior to accepting engagements to determine if there were any independence concerns.

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<sup>15</sup> At the time this paper was developed, the IESBA Code (revised July 2000—the revised Code) was not yet effective (effective from January 1, 2011). As such, material provided by Networks participating in the development of this paper would not have necessarily reflected all revisions to the Code. IESBA staff have prepared materials to support implementation of the revised Code including comparative analysis between the current code and the revised code. See <http://www.ifac.org/Ethics/Resources.php#implementation-and-adoption>

The Networks reviewed for this paper place significant focus on identifying issues associated with independence and conflict of interest. The checklist below illustrates the types of enquiries made by the Networks in this respect.

Compliance with Ethical Requirements	Yes/ No	Other relevant information. A “Yes” response in particular should be further explained— where applicable supported by how the risk is to be mitigated to an acceptable level
Are we aware of the independence rules to be applied in this engagement?		Give detail
Has our research (including enquiry, common sense knowledge) into the ownership and broader structure within which the entity operates highlighted other entities within the ownership and affiliation structure which might be affected by the proposed engagement?		
Have we identified any potential independence-impairments with the entity and the Network that would preclude the Firm from performing the engagement?		
Have we identified any potential conflict of interest with the entity and our Network that would preclude the Firm from performing the engagement?		
<p>Is the Firm or the Network in any way connected with the entity equivalent to an employee or management? Consider:</p> <ul style="list-style-type: none"> <li>• Committing the entity to transactions</li> <li>• Having authority or custody over entity assets</li> <li>• Authority to make decisions for the entity</li> <li>• Preparing source documents for entity transactions</li> </ul>		
Does the Network have any business relationships, financial interests or loans with this entity?		
Are we aware of any member of the Firm’s engagement team having any potential employment with the entity, or been employed by the entity in the		

Compliance with Ethical Requirements	Yes/ No	Other relevant information. A “Yes” response in particular should be further explained—where applicable supported by how the risk is to be mitigated to an acceptable level
last 2 years?		
Does any partner of the Firm have family or personal relationships with the entity or any direct financial or indirect financial interest in the entity?		
Does any of the Firm’s staff that will be part of the engagement have family or personal relationships with the entity or any financial interest in the entity?		
Does the Firm have any <b>former</b> Partner or practice staff members who are in a director/executive role or employee of the entity?		
Does the Firm have a commission contingent fee arrangement with the entity on any attest or non-attest service?		
Does the Firm have deferred credit terms with the entity or unpaid fees which extend beyond one year?		
Does the Firm deliver non-audit services to the entity in a manner that non-audit fees may exceed audit fees or be seen to impair auditor independence?		
Will acceptance of the audit engagement potentially preclude under-taking a significant assignment for another part of the Network?		
<p>Does the Firm perform ANY of the following services for the entity—for example, though not limited to:</p> <ul style="list-style-type: none"> <li>• Bookkeeping</li> <li>• Internal audit</li> <li>• Actuarial services</li> <li>• Financial advisory or valuation services</li> <li>• Legal services</li> <li>• Financial information systems design and</li> </ul>		

CLIENT ACCEPTANCE AND CONTINUANCE

Compliance with Ethical Requirements	Yes/ No	Other relevant information. A “Yes” response in particular should be further explained—where applicable supported by how the risk is to be mitigated to an acceptable level
implementation <ul style="list-style-type: none"> <li>• Executive recruiting</li> <li>• Contingent fee arrangements</li> <li>• Limitation of liability arrangements</li> </ul>		
Does the entity’s audit committee have any issue regarding this engagement?		
Does the Firm have any issues with respect to meeting the independence rules of other regulatory bodies?		
Is the Firm aware of any other possible issues which require the need for further research about our independence or the need for further consultation with an Independence Specialist?		
Is the entity subject to SEC or regulatory rules?		
Is there actual or threatened significant disputes/litigation involving the entity and the Firm?		
Does this engagement involve a limitation of liability?		
Is the Firm providing litigation support or dispute analysis services to another client that might be considered to be in conflict with the interests of this entity?		

Overall Assessment

Will acceptance of this engagement create an independence violation?		
Will acceptance of this engagement create a conflict of interest?		
Please rate the independence risk?		

Please rate the potential conflict of interest risk?		
(Where applicable) Does the Independence Specialist agree with plans to reduce identified risks to an acceptable level (document in the working file)		

Additional resources employed by networks to assist in reducing risk associated with ethical considerations

To aid assessing compliance with ethical requirements, some Networks have developed resources which assist in helping to match or identify possible conflicts. The degree of sophistication and maturity of these systems vary. These additional resources, essentially IT based, help to ensure possible issues are brought to the attention of the Network early in the assessment process. The practical devices some of the Networks reviewed have developed to help them achieve better risk management with respect to ethical compliance include:

- Creating and regularly maintaining a client services database serving as a reference point which the Network Firm must access and consider as part of the assessment when contemplating providing new services. When consideration is being given to accepting a new engagement with a client already present within the database, consultation with those responsible for those existing services must be performed and include involvement of in-house Independence Specialists;
- Use of automated systems which electronically match the Network’s database of clients (or potential clients) with the investment portfolios of designated Network staff and designated others (e.g.: their immediate family members) highlighting possible risks for further consideration. The need and size of such a system was viewed by one Network as arguably scalable dependent upon the investment culture or focus in the jurisdiction/area where the Firm operates. For example, the need and usefulness of such a system would arguably be more necessary and beneficial in an environment which has more of an investment culture in stocks/shares vs. one which may, for example, focus more on non-share based investments such as real estate;
- One Network highlighted that a very simple approach to assisting with highlighting conflicts was to e-mail other Network Firms in the jurisdiction(s) where the potential client has operations, as well as enquiry from the potential client as to whether they are aware of other services offered by Network Firms to entities in the group.

Safeguards to consider in addressing conflicts of interest

Should issues with respect to independence or conflicts of interest be noted in considering client acceptance, there are actions that could be taken by Networks which could help mitigate those risks to reduce them to an acceptable level. As noted by one Network, these would depend upon the environment in which a Firm operates and especially whether the service can be performed with the necessary objectivity. As such, this Network indicates that it may be possible to implement and maintain safeguards that are designed to manage conflicts and protect client confidentiality in relation to a specific engagement, thereby enabling it to:

- (a) Act for two or more parties to a transaction or other matter or
- (b) Accept other prospective engagements where they could not do so in the absence of such safeguards. These safeguards would ordinarily include but are not limited to the following:
  - (i) subject to entity and other confidentiality obligations, disclosing the facts and circumstances of the conflict to the entities concerned (understanding any entity-imposed confidentiality requirements and obtain consent, as appropriate);
  - (ii) obtain the consent of each of the parties concerned.

After obtaining consents from the parties concerned, the Network highlights that the following safeguards would ordinarily be considered:

- Using entirely separate engagement teams to serve each respective client;
- Establishing effective ethical walls and confidentiality safeguards, such as information and physical barriers separating engagement teams designed to prevent the sharing of confidential information;
- Information technology safeguards such as passwords, limited network access, and separate printers and fax machines; and
- Instructing individuals on the engagement team, including administrative personnel who assist the engagement team on the importance of maintaining confidentiality, including custody of client documents and communication protocols, such as restricting discussion to those who “need-to-know.”

However, the Network further notes that not all conflicts can be waived by a client and/or managed by implementing safeguards. As such, if they are unable to implement appropriate safeguards to manage a conflict, the prospective engagement should be declined.

#### D. *Additional Considerations with Client Acceptance*

Who is Involved in Completing Client Acceptance Assessments/Documentation?

The level and extent of involvement of Firm personnel in the performance of client acceptance determinations varies across the Networks reviewed—though commonality does exist. Some factors in assessing the entity can result in risk associated with the overall engagement being such that the views and approval of others within the Network must be obtained in order for a final decision on whether to accept the engagement can be made.

As explained by one Network, the underlying approach in completing client acceptance (and also continuance) assessments is that the higher the risk associated with the potential (or continuing) client, there was a corresponding need for additional involvement, consultation and approval by others within the Firm. It was noted that it would be in rare circumstances that there would not be the need to have at least one other Partner, who is not associated with introducing the potential client to the Firm or the performance of the initial acceptance assessment, to perform their own “independent” review and concur with the decision to accept the potential client.

While there is variation amongst the Networks considered, the following provides an overall **general** illustrative framework followed by many of the Networks reviewed in the completion of their client acceptance assessments:

- All client acceptance assessments must include Partner level involvement as a minimum (involvement of the Audit Manager is also noted by some Networks). While the need for Partner level involvement was consistent across Networks, the nature of who the Partner could be varied from the Recommending Partner to the prospective Engagement Partner;
- The need for second/additional Partner involvement (and concurrence) was also commonly noted with the need for their participation required across a range of risk thresholds varying from when engagement risk was assessed from “normal” to “high;”
- Where the assessment is being made within an industry for which an industry/sector specialist exists, then the input of the specialist should be sought – in particular in instances involving a risk assessment beyond normal;
- Should the engagement risk be above normal, then there is a need to involve and gain the concurrence of more specialized Firm personnel. The title of those to be consulted varied, but could be characterized as the local Firm’s audit risk specialist (or person of equivalent role)/specialist for quality control; and
- If the risk is considered extremely high, then involvement of the Firm’s country level audit risk specialist/head of risk management should be sought. The existence of a National Committee was also noted to assist in reviewing potentially higher risk clients.

#### Documentation

ISQC 1 contains requirements specifically with respect to documentation. Paragraph 27 (c) notes:

If issues have been identified, and the Firm decides to accept or continue the client relationship or a specific engagement, the Firm (shall) document how the issues were resolved.

Documentation in general with respect to client acceptance and continuance was an area for which the TAC’s review of external quality assurance reports indicated was a notable issue—an absence of recording within the audit file corresponding to a lack of documented evidence.

As noted in the South African review report:

While quality audit work was evident throughout our reviews, we continue to identify a number of instances where engagement files do not adequately comply with the professional standards in relation to documentation. The requirement for the auditor to document matters providing evidence to support the audit opinion has existed for many years and the lack of such documentation remains unacceptable.

A similar comment was noted from Australia’s oversight body:

Across most Firms, we continue to note deficiencies in the application of policy for both the adequacy of documentation supporting the decision to provide non-audit services for audit clients...

Further, reviews performed by the PCAOB in the US noted several instances where the broader more general issue of adequacy of documentation associated with several review findings was also evident.

In developing this paper, one of the Networks highlighted, more with respect to client continuance considerations, that the thorough documentation of “thought processes” can be a challenge. While all the necessary considerations may have taken place and rationale determined in deciding on the future relationship with a client, ensuring all those thought-processes are actually documented in the audit file can be an issue.

To assist ensuring that all aspects of the Network's client acceptance and continuance policies are addressed and documented, all Networks employ checklists. The use of software applications to assist in the completion of such checklists can be an added feature.

Where the use of electronic checklists is available, this can not only enhance documentation but also be a useful tool for risk assessment purposes. As noted in some Networks, each individual question can be linked to a related numeric risk indicator and assist in forming the overall risk assessment for that particular client – the general idea being the client achieves a risk “score,” different scores **contributing** to (but not determining) the final assessment of risk associated with that client. The score can then be subsequently reduced by the nature of any risk mitigating solutions implemented.

#### Timing of Procedures Associated With Client Acceptance

As with documentation, the timing of completion of acceptance and continuance procedures was also a key finding in the TAC's review of external inspection reports. Some comments were:

- In some situations, the detailed consideration of the factors affecting a decision to continue an existing client audit relationship normally occurs after the Firm has been appointed as auditor at the client's Annual General Meeting (AGM), but before detailed audit planning commences. In some cases, the continuance procedures may not be documented until well after the completion of the planning phase (Canada).
- Across most Firms, we continue to note deficiencies in the...timing of issuance of engagement letters, for both new clients and new services to existing clients, before completing the relevant continuance or acceptance processes. (Australia).

Networks emphasized that it was important for client acceptance evaluations to be completed before proposing or committing to accept the engagement. Further, they highlighted that in situations where all necessary procedures have not been completed, consideration should be given to disclosing that the Firm's proposal or commitment to perform the engagement is subject to satisfactory completion of engagement acceptance procedures.

Once acceptance procedures have been completed, the general requirement amongst the Networks is that only **continuance** procedures need be subsequently used, though it was noted that at least one Network does require that once a client has been accepted, re-performance of the complete client **acceptance** process be carried out **at least** once every five years over and above the usual annual client continuance assessment.

One Network acknowledged that client acceptance requirements not being completed before starting an engagement may have been an issue some years ago but was seemingly not a significant problem area today. To help reach this level of compliance the Network had implemented, as a key part of their corporate climate, a strong element of training to emphasize the risks associated with not completing required procedures within the appropriate timeframe and the accountability of staff for not doing so.

Despite this it was acknowledged by some Networks that timely performance of acceptance procedures can still pose difficulties in practice. As such, some Networks have adopted tools to assist in ensuring that such departures from policy are minimized. Practical steps that Networks could consider to reduce the likelihood of timing issues include:

- In those parts of the business where these types of issues arise, ensuring that a dedicated resource is available to assist in the quick completion of the acceptance process; and
- Ensuring there is frequent communication between the Quality Assurance function and the engagement partners to ensure at least an established “minimum threshold of procedures” is completed on time. If not fully completed within 30 days after a job coding has been created, a policy requirement that the engagement must be suspended.

### Generic, Sector-Specific and SME Policies and Procedures

While many of the Networks reviewed have more of a “one size fits all” approach to their acceptance and continuance policies and related questionnaires, some Networks have invested in the development of industry specific client acceptance tools—focusing in on the key risk areas associated with that particular sector which should be given special consideration in determining client acceptance.

An approach used by one Network is the development of global template assessment forms which differ by industry and can be tailored by each territory for local purposes. At this Network, there are several assessment forms ranging from industry specific forms for bank and capital market clients to generic forms (intended for consumer & industrial products, manufacturing, and technology industry clients). In providing these sector-specific forms, the Network emphasizes that the underlying client acceptance and continuance policies are the same across all industries.

A further approach to tailoring policies and procedures at one Network is the issuance of specific guidance documents in response to industries experiencing heightened risk. This Network has issued, for example, acceptance/re-acceptance guidance specifically for the financial industry, given recent developments in that industry.

Tailored policies and procedures for smaller lower risk clients is an area of growing interest for several Networks reviewed. A couple of Networks do provide for a “simplified” process for assessing acceptance although, as with the industry specific templates discussed above, the underlying acceptance policies in relation to that assessment are no different to the regular generic acceptance assessments. One Network noted that their procedures are currently designed to address all acceptances but theoretically, in an SME context, would be quicker to complete with less elevated sign-off where the business is simpler in nature.

## 2. Client Continuance

Common across the Networks reviewed is that the general themes underlying considerations for determining client continuance are essentially the same as those applied in determining client acceptance. Central to the continuance assessment is an evaluation of new or changed potential risks of association with the client.

As noted by one Network, the Partners on the engagement should be alert to and monitor changes in factors and conditions occurring during the engagement that could negatively impact the initial assessment of engagement risk. Of the Networks reviewed this would particularly include monitoring of changes associated with:

- Principal decision makers, directors and officers, or owners;
- Financial condition;

- Industry and business environment issues that increase risk (e.g. economic trends, inflation or deflation, industry consolidation, litigation, regulatory environment, expansion into new areas of business);
- Auditor-client relationship; and
- Business and reputation of the client.

Where changes are considered significant, then consideration is given as to whether the significance of the change justifies a complete reassessment of the client using a Network’s more detailed acceptance questionnaire. One Network highlights that this is an approach required in those circumstances where an existing private audit client is considering going public, or where an existing audit client is acquiring, or is being acquired by an entity that is public.

In reviewing the checklists of the participating Networks, the following were noted as areas of enquiry focused more specifically on continuance, presented below as an illustrative checklist:

<b>Client Continuance</b>	<b>Yes/ No</b>	<b>Other relevant information. A “Yes” response in particular should be further explained— where applicable supported by how the risk is to be mitigated to an acceptable level</b>
Compared to the previous year, and based on your enquiries, are there any new circumstances that might impair our independence as auditors of this entity under the Firm’s policies or the applicable professional or regulatory independence requirements? Consider in particular any changes in the client’s structure, circumstances, ownership or management.		
Has the entity recently had significant and numerous acquisitions?		
Is there any indication that in the past three years, the entity requested a change in Engagement Leader or Team Manager?		
Have we had any disagreement with the entity or communicated a significant matter to the entity’s regulator?		
Has the chief executive officer or controller (or the equivalent) been replaced within the last year?		
Are there any issues related to payment of audit fees?		

Client Continuance	Yes/ No	Other relevant information. A “Yes” response in particular should be further explained—where applicable supported by how the risk is to be mitigated to an acceptable level
Is there any issue on any imposed scope limitation?		
Are there any issues in relation to being able to adequately staff the audit?		

*Timing of Procedures*

Networks reviewed require the completion of continuance assessments at least annually with the understanding that the factors considered under client acceptance should be kept under continuous review. This is particularly important in the early years of a client relationship as the extent of knowledge a Network will have regarding the client will generally grow within the context of the on-going relationship.

As to when exactly during the year performance of the continuance considerations are to be formally performed and documented - this varies between Networks. However, those reviewed generally consider the timing to be most effective if performed/approved either directly after completion of the last audit and no later than three months prior to the end of the financial period to be audited. The general themes noted with respect to who is involved and approvals required in completing the continuance assessment were noted by one Network as being similar to those when contemplating initial client acceptance—repeating the underlying concept that the higher the assessed risk associated with continuing with the client, there was a corresponding need for additional involvement, consultation and approval by others within the Firm.

As an added assurance that there have been no circumstances that have developed which could affect the continuance of the engagement, it was already noted earlier in the paper that at least one Network requires that the **complete** client acceptance questionnaire be completed in totality at least once every five years.

The formal establishment of a continuance review process for engagements spanning more than one year was also noted as a mandatory requirement at one Network. Establishment of the process involves senior risk management and audit personnel of the Firm.

*Termination/Withdrawal*

As part of the establishment of policies and procedures on continuing an engagement, paragraph 28 of ISQC 1 requires those policies to address circumstances where the Firm obtains information that would have caused it to decline the engagement had that information been available earlier—and should cover:

- (a) The professional and legal responsibilities that apply to the circumstances, including whether there is a requirement to report to those who made the appointment or, in some cases, to regulatory authorities; and

- (b) The possibility of withdrawing from the engagement or from both the engagement and the client relationship.

This is supported by paragraphs A22–A23<sup>16</sup> which highlight that those policies and procedures address issues that include the following:

- Discussing with the appropriate level of the client’s management and those charged with its governance the appropriate action that the Firm might take based on the relevant facts and circumstances.
- If the Firm determines that it is appropriate to withdraw, discussing with the appropriate level of the client’s management and those charged with its governance withdrawal from the engagement or from both the engagement and the client relationship, and the reasons for the withdrawal.
- Considering whether there is a professional, legal or regulatory requirement for the Firm to remain in place, or for the Firm to report the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities.
- Documenting significant matters, consultations, conclusions and the basis for the conclusions.

Some additional requirements noted in reviewing the Networks were the need to give consideration to:

- Seeking legal counsel where warranted by the circumstances; and
- At a minimum, seeking the concurrence of the Risk Specialist/Partner. In addition, concurrence of the Firm’s Assurance Leader can also be required.

With particular respect to international engagements, it was noted:

- communicate, if permissible, with the participating Firms as to the implications of withdrawing; and
- where applicable, consulting with the referring member Firm before reaching a final decision.

If the termination is being driven by the discovery of a conflict, an option noted was that subject to local laws, giving consideration to obtaining an engagement letter with terms that provide the right to terminate an engagement in the event that a conflict arises that cannot be resolved. However, it was noted that in some circumstances, it may be possible to continue with the engagement by disclosing the conflict to the client and obtaining the client’s waiver or consent to continuance of the engagement by adopting other safeguards as appropriate.

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<sup>16</sup> A23 highlights public sector considerations—see footnote 10.

**Appendix 1: External Inspection Reports Reviewed**

<b>Name of Body</b>	<b>Country</b>	<b>Name of Report</b>
Australian Securities & Investments Commission (ASIC) <a href="http://www.asic.gov.au">http://www.asic.gov.au</a>	Australia	Audit inspection program Public report for 2006–07. Dated June 2008
Canadian Public Accountability Board (CPAB) <a href="http://www.cpab-ccrc.ca">www.cpab-ccrc.ca</a>	Canada	Fifth (February 2008) and Sixth (March 2009) Public Reports—Inspections of the Quality of Audits Conducted by Public Accounting Firms
Hong Kong Institute of Certified Public Accountants (HKICPA) <a href="http://www.hkicpa.org.hk/">http://www.hkicpa.org.hk/</a>	Hong Kong	Practice Review Committees Report 2007
Japanese Institute of Certified Public Accountants (JICPA) <a href="http://www.fsa.go.jp/cpaaob/english/index.html">http://www.fsa.go.jp/cpaaob/english/index.html</a>	Japan	Overview of the Results of Quality Control Review for the Year Ended March 31, 2007
Accounting and Corporate Regulatory Authority (ACRA) <a href="http://www.acra.gov.sg">www.acra.gov.sg</a>	Singapore	Practice Monitoring Programme Public Report July 2007 and July 2008
Independent Regulatory Board for Auditors (IRBA) <a href="http://irba.co.za/">http://irba.co.za/</a>	South Africa	Practice Review Department 2007 to 2008 Reviews Public Report May 2009
Audit Inspection Unit (AIU) <a href="http://www.frc.org.uk/poba">www.frc.org.uk/poba</a>	United Kingdom	2006/07 Audit Quality Inspections Public Report - June 2007  2007/8 Audit Quality Inspections (An Overview) with the related individual reports for individual Firms (BDO, DTT, EY, GT, KPMG, PKF & PWC)—December 8 2008
Public Company Oversight Board (PCAOB) <a href="http://www.pcaobus.org">www.pcaobus.org</a>	United States	PCAOB Inspection Reports

**Appendix 2: Full Members of the Forum of Firms (as of January 1, 2010)**

BDO

Constantin Associates Network

Crowe Horwath International

Deloitte Touche Tohmatsu Limited

Ernst & Young Global Limited

Grant Thornton International Ltd

HLB International

IEC

INPACT Audit Limited

JHI

JPA International

KPMG International Cooperative

Mazars

Moore Stephens International Limited

PKF International Limited

PricewaterhouseCoopers International

RSM International Limited

Russell Bedford International

SMS Latinoamérica

Talal Abu Ghazaleh & Co. International

UHY International Limited

### Appendix 3: Comparison of Client Acceptance and Continuance Requirements

<p style="text-align: center;"><b>Clarified ISQC 1</b> <b>Effective December 15, 2009</b></p> <p style="text-align: center;"><b>2009 Handbook of International Auditing, Assurance, and Ethics Pronouncements</b></p>	<p style="text-align: center;"><b>ISQC 1</b></p> <p style="text-align: center;"><b>2008 Handbook of International Auditing, Assurance, and Ethics Pronouncements</b></p>
<p>26. The Firm shall establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide the Firm with reasonable assurance that it will only undertake or continue relationships and engagements where the Firm:</p> <ul style="list-style-type: none"> <li>(a) Is competent to perform the engagement and has the capabilities, including time and resources, to do so; (Ref: Para. A18, A23)</li> <li>(b) Can comply with relevant ethical requirements; and</li> <li>(c) Has considered the integrity of the client, and does not have information that would lead it to conclude that the client lacks integrity. (Ref: Para. A19-A20, A23)</li> </ul>	<p>28. <b>The Firm should establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide it with reasonable assurance that it will only undertake or continue relationships and engagements where it:</b></p> <ul style="list-style-type: none"> <li>(a) <b>Has considered the integrity of the client and does not have information that would lead it to conclude that the client lacks integrity;</b></li> <li>(b) <b>Is competent to perform the engagement and has the capabilities, time and resources to do so; and</b></li> <li>(c) <b>Can comply with ethical requirements.</b></li> </ul>
<p>27. Such policies and procedures shall require:</p> <ul style="list-style-type: none"> <li>(a) The Firm to obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. (Ref: Para. A21, A23)</li> <li>(b) If a potential conflict of interest is identified in accepting an engagement from a new or an existing client, the Firm to determine whether it is appropriate to accept the engagement.</li> <li>(c) If issues have been identified, and the Firm decides to accept or continue the client relationship or a specific engagement, the Firm to document how the issues were resolved.</li> </ul>	<p>28 (contd) <b>The Firm should obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client.</b></p> <p>32. The Firm also considers whether accepting an engagement from a new or an existing client may give rise to an actual or perceived conflict of interest. Where a potential conflict is identified, the Firm considers whether it is appropriate to accept the engagement.</p> <p>28 (contd) <b>Where issues have been identified, and the Firm decides to accept or continue the client relationship or a specific engagement, it should document how the issues were resolved.</b></p>
<p>28. The Firm shall establish policies and procedures on continuing an engagement and the client relationship, addressing the circumstances where the Firm obtains information that would have caused it to decline the engagement had that information been available earlier. Such policies and procedures shall include consideration of:</p>	<p>34. <b>Where the Firm obtains information that would have caused it to decline an engagement if that information had been available earlier, policies and procedures on the continuance of the engagement and the client relationship should include consideration of:</b></p>

<p style="text-align: center;"><b>Clarified ISQC 1</b> <b>Effective December 15, 2009</b></p> <p style="text-align: center;"><b>2009 Handbook of International Auditing, Assurance, and Ethics Pronouncements</b></p>	<p style="text-align: center;"><b>ISQC 1</b></p> <p style="text-align: center;"><b>2008 Handbook of International Auditing, Assurance, and Ethics Pronouncements</b></p>
<p>(a) The professional and legal responsibilities that apply to the circumstances, including whether there is a requirement for the Firm to report to the person or persons who made the appointment or, in some cases, to regulatory authorities; and</p> <p>(b) The possibility of withdrawing from the engagement or from both the engagement and the client relationship. (Ref: Para. A22-23)</p>	<p>(a) <b>The professional and legal responsibilities that apply to the circumstances, including whether there is a requirement for the Firm to report to the person or persons who made the appointment or, in some cases, to regulatory authorities; and</b></p> <p>(b) <b>The possibility of withdrawing from the engagement or from both the engagement and the client relationship.</b></p>
<p><i>Competence, Capabilities, and Resources</i> (Ref: Para. 26(a))</p> <p>A18. Consideration of whether the Firm has the competence, capabilities, and resources to undertake a new engagement from a new or an existing client involves reviewing the specific requirements of the engagement and the existing partner and staff profiles at all relevant levels, and including whether:</p> <ul style="list-style-type: none"> <li>• Firm personnel have knowledge of relevant industries or subject matters;</li> <li>• Firm personnel have experience with relevant regulatory or reporting requirements, or the ability to gain the necessary skills and knowledge effectively;</li> <li>• The Firm has sufficient personnel with the necessary competence and capabilities;</li> <li>• Experts are available, if needed;</li> <li>• Individuals meeting the criteria and eligibility requirements to perform engagement quality control review are available, where applicable; and</li> <li>• The Firm is able to complete the engagement within the reporting deadline.</li> </ul>	<p>31. In considering whether the Firm has the capabilities, competence, time and resources to undertake a new engagement from a new or an existing client, the Firm reviews the specific requirements of the engagement and existing partner and staff profiles at all relevant levels. Matters the Firm considers include whether:</p> <ul style="list-style-type: none"> <li>• Firm personnel have knowledge of relevant industries or subject matters;</li> <li>• Firm personnel have experience with relevant regulatory or reporting requirements, or the ability to gain the necessary skills and knowledge effectively;</li> <li>• The Firm has sufficient personnel with the necessary capabilities and competence;</li> <li>• Experts are available, if needed;</li> <li>• Individuals meeting the criteria and eligibility requirements to perform engagement quality control review are available, where applicable; and</li> <li>• The Firm is able to complete the engagement within the reporting deadline.</li> </ul>
<p><i>Integrity of Client</i> (Ref: Para. 26(c))</p> <p>A19. With regard to the integrity of a client, matters to consider include, for example:</p> <ul style="list-style-type: none"> <li>• The identity and business reputation of the client’s principal owners, key management, and those charged with its governance.</li> <li>• The nature of the client’s operations, including its business practices.</li> <li>• Information concerning the attitude of the client’s</li> </ul>	<p>29. With regard to the integrity of a client, matters that the Firm considers include, for example:</p> <ul style="list-style-type: none"> <li>• The identity and business reputation of the client’s principal owners, key management, related parties and those charged with its governance.</li> <li>• The nature of the client’s operations, including its business practices.</li> <li>• Information concerning the attitude of the</li> </ul>

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<p>principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.</p> <ul style="list-style-type: none"> <li>• Whether the client is aggressively concerned with maintaining the Firm’s fees as low as possible.</li> <li>• Indications of an inappropriate limitation in the scope of work.</li> <li>• Indications that the client might be involved in money laundering or other criminal activities.</li> <li>• The reasons for the proposed appointment of the Firm and non reappointment of the previous Firm.</li> <li>• The identity and business reputation of related parties.</li> </ul> <p>The extent of knowledge a Firm will have regarding the integrity of a client will generally grow within the context of an ongoing relationship with that client.</p>	<p>client’s principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.</p> <ul style="list-style-type: none"> <li>• Whether the client is aggressively concerned with maintaining the Firm’s fees as low as possible.</li> <li>• Indications of an inappropriate limitation in the scope of work.</li> <li>• Indications that the client might be involved in money laundering or other criminal activities.</li> <li>• The reasons for the proposed appointment of the Firm and non reappointment of the previous Firm.</li> </ul> <p>The extent of knowledge a Firm will have regarding the integrity of a client will generally grow within the context of an ongoing relationship with that client.</p>
<p>A20. Sources of information on such matters obtained by the Firm may include the following:</p> <ul style="list-style-type: none"> <li>• Communications with existing or previous providers of professional accountancy services to the client in accordance with relevant ethical requirements, and discussions with other third parties.</li> <li>• Inquiry of other Firm personnel or third parties such as bankers, legal counsel and industry peers.</li> <li>• Background searches of relevant databases.</li> </ul>	<p>30. Information on such matters that the Firm obtains may come from, for example:</p> <ul style="list-style-type: none"> <li>• Communications with existing or previous providers of professional accountancy services to the client in accordance with the Code, and discussions with other third parties.</li> <li>• Inquiry of other Firm personnel or third parties such as bankers, legal counsel and industry peers.</li> <li>• Background searches of relevant databases.</li> </ul>
<p><i>Continuance of Client Relationship</i> (Ref: Para. 27(a))</p> <p>A21. Deciding whether to continue a client relationship includes consideration of significant matters that have arisen during the current or previous engagements, and their implications for continuing the relationship. For example, a client may have started to expand its business operations into an area where the Firm does not possess the necessary expertise.</p>	<p>33. Deciding whether to continue a client relationship includes consideration of significant matters that have arisen during the current or previous engagements, and their implications for continuing the relationship. For example, a client may have started to expand its business operations into an area where the Firm does not possess the necessary knowledge or expertise.</p>
<p><i>Withdrawal</i> (Ref: Para. 28)</p> <p>A22. Policies and procedures on withdrawal from an engagement or from both the engagement and the client relationship address issues that include the following:</p>	<p>35. Policies and procedures on withdrawal from an engagement or from both the engagement and the client relationship address issues that include the following:</p>

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<ul style="list-style-type: none"> <li>• Discussing with the appropriate level of the client’s management and those charged with its governance the appropriate action that the Firm might take based on the relevant facts and circumstances.</li> <li>• If the Firm determines that it is appropriate to withdraw, discussing with the appropriate level of the client’s management and those charged with its governance withdrawal from the engagement or from both the engagement and the client relationship, and the reasons for the withdrawal.</li> <li>• Considering whether there is a professional, legal or regulatory requirement for the Firm to remain in place, or for the Firm to report the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities.</li> <li>• Documenting significant matters, consultations, conclusions and the basis for the conclusions.</li> </ul>	<ul style="list-style-type: none"> <li>• Discussing with the appropriate level of the client’s management and those charged with its governance regarding the appropriate action that the Firm might take based on the relevant facts and circumstances.</li> <li>• If the Firm determines that it is appropriate to withdraw, discussing with the appropriate level of the client’s management and those charged with its governance withdrawal from the engagement or from both the engagement and the client relationship, and the reasons for the withdrawal.</li> <li>• Considering whether there is a professional, regulatory or legal requirement for the Firm to remain in place, or for the Firm to report the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities.</li> <li>• Documenting significant issues, consultations, conclusions and the basis for the conclusions.</li> </ul>
<p><i>Considerations Specific to Public Sector Audit Organizations</i> (Ref: Para. 26-28)</p> <p>A23. In the public sector, auditors may be appointed in accordance with statutory procedures. Accordingly, certain of the requirements and considerations regarding the acceptance and continuance of client relationships and specific engagements as set out paragraphs 26-28 and A18-A22 may not be relevant.</p> <p>Nonetheless, establishing policies and procedures as described may provide valuable information to public sector auditors in performing risk assessments and in carrying out reporting responsibilities.</p>	<p>Public Sector Perspective</p> <p>3. <i>In the public sector, auditors may be appointed in accordance with statutory procedures. Accordingly, considerations regarding the acceptance and continuance of client relationships and specific engagements, as set out in paragraphs 28–35 of ISQC 1, may not apply.</i></p>

## **Appendix 4: Obligations of Membership to the Forum of Firms**

The Forum's membership obligations, with respect to transnational audits require Members to:

1. Maintain appropriate quality control standards in accordance with International Standards on Quality Control issued by the IAASB in addition to relevant national quality control standards and conduct, to the extent not prohibited by national regulation, regular globally coordinated internal quality assurance reviews.
2. Have policies and methodologies for the conduct of such audits that are based, to the extent practicable, on ISAs
3. Have policies and methodologies which conform to the IESBA Code of Ethics for Professional Accountants and national codes of ethics.

Refer to the Forum of Firms Constitution for further detail:

[http://www.ifac.org/Forum\\_of\\_Firms/FoF\\_Constitution\\_February\\_22\\_2007\\_Final.pdf](http://www.ifac.org/Forum_of_Firms/FoF_Constitution_February_22_2007_Final.pdf)

## **Appendix 5: Requirements of ISA 220, *Quality Control for an Audit of Financial Statements*, and ISA 600 *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)***

ISA 220:

With respect to client acceptance and continuance, ISA 220 states:

12. The engagement partner shall be satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and audit engagements have been followed, and shall determine that conclusions reached in this regard are appropriate. (Ref: Para. A8-A9)
13. If the engagement partner obtains information that would have caused the Firm to decline the audit engagement had that information been available earlier, the engagement partner shall communicate that information promptly to the Firm, so that the Firm and the engagement partner can take the necessary action. (Ref: Para. A9)

ISA 600:

With respect to client acceptance and continuance, ISA 600 states:

12. In applying ISA 220, the group engagement partner shall determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained in relation to the consolidation process and the financial information of the components on which to base the group audit opinion. For this purpose, the group engagement team shall obtain an understanding of the group, its components, and their environments that is sufficient to identify components that are likely to be significant components. Where component auditors will perform work on the financial information of such components, the group engagement partner shall evaluate whether the group engagement team will be able to be involved in the work of those component auditors to the extent necessary to obtain sufficient appropriate audit evidence. (Ref: Para. A10–A12)
13. If the group engagement partner concludes that:
  - (a) it will not be possible for the group engagement team to obtain sufficient appropriate audit evidence due to restrictions imposed by group management; and
  - (b) the possible effect of this inability will result in a disclaimer of opinion on the group financial statements,<sup>17</sup>
 the group engagement partner shall either:
  - (a) in the case of a new engagement, not accept the engagement, or, in the case of a continuing engagement, withdraw from the engagement, where withdrawal is possible under applicable law or regulation; or
  - (b) where law or regulation prohibits an auditor from declining an engagement or where withdrawal from an engagement is not otherwise possible, having performed the audit of the group financial statements to the extent possible, disclaim an opinion on the group financial statements. (Ref: Para. A13–A19)

Terms of Engagement

14. The group engagement partner shall agree on the terms of the group audit engagement in accordance with ISA 210.<sup>18</sup> (Ref: Para. A20–A21)

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<sup>17</sup> ISA 705, *Modifications to the Opinion in the Independent Auditor's Report*

<sup>18</sup> ISA 210, *Agreeing the Terms of Audit Engagements*

## **Appendix 6: Guidance in A19 of ISQC 1**

With regard to the integrity of a client, matters to consider include, for example:

- The identity and business reputation of the client's principal owners, key management, and those charged with its governance.
- The nature of the client's operations, including its business practices.
- Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.
- Whether the client is aggressively concerned with maintaining the Firm's fees as low as possible.
- Indications of an inappropriate limitation in the scope of work.
- Indications that the client might be involved in money laundering or other criminal activities.
- The reasons for the proposed appointment of the Firm and non-reappointment of the previous Firm.
- The identity and business reputation of related parties.

The extent of knowledge a Firm will have regarding the integrity of a client will generally grow within the context of an ongoing relationship with that client.

## **Appendix 7: Guidance in A18 of ISQC 1**

Consideration of whether the Firm has the competence, capabilities, and resources to undertake a new engagement from a new or an existing client involves reviewing the specific requirements of the engagement and the existing partner and staff profiles at all relevant levels, and including whether:

- Firm personnel have knowledge of relevant industries or subject matters;
- Firm personnel have experience with relevant regulatory or reporting requirements, or the ability to gain the necessary skills and knowledge effectively;
- The Firm has sufficient personnel with the necessary competence and capabilities;
- Experts are available, if needed;
- Individuals meeting the criteria and eligibility requirements to perform engagement quality control review are available, where applicable; and
- The Firm is able to complete the engagement within the reporting deadline.



**International Federation of Accountants**

545 Fifth Avenue, 14<sup>th</sup> Floor, New York, NY 10017 USA

Tel +1 (212) 286-9344 Fax +1(212) 286-9570 [www.ifac.org](http://www.ifac.org)