

### Objective of this Document

The purpose of this document is to demonstrate the proposals of the Quality Control Task Force (QCTF) in the context of adopting a quality management approach in ISQC 1. This agenda item is the same as **Agenda Item D.1**, however reflects a marked version to highlight updates since the IAASB June 2017 discussion that have not yet been discussed with the IAASB (the QCTF needs to further deliberate various proposals of the IAASB in order to fully address all of their comments, and therefore this draft does not reflect all possible changes). Please note, the marked changes are from previous IAASB discussion and do not represent changes from extant.

The requirements and application material set out below are in draft form and will be further refined as the Exposure Draft is developed. *At this stage, the QCTF is seeking directional input and is not seeking feedback on the proposed drafting set out in this working draft.*

### QUALITY MANAGEMENT: WORKING DRAFT OF ISQC 1 (Marked from Board)

## INTERNATIONAL STANDARD ON QUALITY CONTROL 1 (REVISED)

### QUALITY MANAGEMENT FOR FIRMS THAT PERFORM AUDITS AND REVIEWS OF FINANCIAL STATEMENTS, AND OTHER ASSURANCE AND RELATED SERVICES ENGAGEMENTS

(Effective as of December 15, 20XX)

### [CONTENTS PAGE TO BE INSERTED]

### Introduction

#### Scope of this ISQC

1. This International Standard on Quality Control (ISQC) deals with a firm's responsibilities for its system of quality management and applies to all firms of professional accountants who perform audits and reviews of financial statements, and other assurance and related services engagements. This ISQC sets forth requirements and guidance for the design, implementation and operation of the firm's system of quality management.
2. Other pronouncements of the International Auditing and Assurance Standards Board (IAASB) set out additional standards and guidance on the responsibilities of firm personnel regarding quality management for specific types of engagements. ISA 220,<sup>1</sup> for example, deals with quality management for audits of financial statements. Law, regulation or relevant ethical requirements may also establish additional responsibilities for the firm in relation to quality management beyond those described in this ISQC.

#### The Firm's System of Quality Management

3. A firm's system of quality management supports the objective of the firm ~~to~~ ~~in~~ complying with professional standards and applicable legal and regulatory requirements and issuing reports that are

<sup>1</sup> International Standard on Auditing (ISA) 220, *Quality Control for an Audit of Financial Statements*

appropriate in the circumstances. A firm's system of quality management comprises the following components:

- (a) Governance and leadership, ~~including the organization, culture and strategy of the firm.~~ (Ref. Para A1)
  - (b) Information and communication, together with documentation of the firm's system of quality management. (Ref. Para A2)
  - (c) The quality management process, which is the process by which the firm establishes its quality objectives, identifies and assesses quality risks to meeting those objectives, designs and implements responses to those quality risks, monitors its system of quality management and implements remedial actions to address identified deficiencies. (Ref. Para A3–A4)
4. ~~The operation of these components in an integrated manner forms in order for the system of quality management. The components collectively reduce, to an acceptable level, the risk of the firm not achieving its objective to comply with professional standards and applicable legal and regulatory requirements and issuing reports that are appropriate in the circumstances to properly function, these components operate in conjunction with each other and are interrelated to form the system of quality management.~~
  5. This ISQC establishes governance principles in relation to quality that provide the basis for the design, implementation and operation of the firm's system of quality management. The firm is required to implement actions to address these principles, which include the culture of the firm, the responsibility and accountability of firm leadership, the organization of the firm and the firm's consideration of its stakeholders. (Ref. Para A1)
  6. The quality management process assists the firm in tailoring the system of quality management according to the circumstances of the firm, through establishing quality objectives that are specific to the firm and identifying the risks that, individually or in combination, may adversely affect the firm's ability to achieve its quality objectives. This enables the firm to design and implement responses that are responsive to the quality risks, thereby promoting the effective use of the firm's resources and the effective management of quality. Factors that may affect the firm's system of quality management include, for example, the size and operating characteristics of the firm and whether it is part of a network, the types of services the firm provides, the industries in which it operates, or the nature of the entities to which those services are provided. (Ref. Para A3–A4)
  7. This ISQC includes quality objectives that form the basis for the quality objectives established by the firm, i.e., the firm ~~may identify~~ ies additional specific, or more granular, quality objectives relevant to the firm's circumstances, ~~based on the quality objectives set out in the standard.~~ The firm identifies quality risks in relation to such quality objectives based on the circumstances of the firm and the nature of engagements it performs, which include the prescribed quality risks set out in this ISQC that are relevant to all firms. ~~Furthermore, Based on the assessment of the identified quality risks, the firm designs and implements this ISQC includes responses that firms are required to implement to address the quality risks identified by the firm, set out in this standard, however such responses may not fully address the quality risks, including due to the circumstances of the firm, and the firm may need to design and implement additional responses.~~ (Ref. Para A4)
  8. Quality management is a continuous, dynamic process that involves an ongoing consideration of the relevance and appropriateness of the firm's system of quality management. Changes in the

circumstances affecting the firm (e.g., the types of services the firm provides or the nature of the entities to which those services are provided) or other information (e.g., the results of the firm's monitoring activities or information received through the firm's whistleblowing program) may indicate the need for the firm to consider the continued relevance and appropriateness of its system of quality management and modify it, as necessary.

#### Considerations in Relation to the Size and Complexity of the Firms

9. The components of the firm's system of quality management are applicable to all firms, including smaller firms. However, how the firm establishes its system of quality management may be less formal and extensive for smaller, less complex, firms. For example:

(a) The firm may have a simple organizational structure such that the process for assigning responsibility and accountability for quality to firm leadership is less formalized. For example, firm leadership may assume operational responsibility for the firm's system of quality management. In addition, actions taken to promote the firm's culture may largely involve firm leadership's behavior in their daily activities and decision-making, due to the close and frequent interaction between firm leadership and personnel. For a large firm, there may be more complex leadership structures with designation of authority across various personnel, and there may be varying actions taken to promote the firm's culture.

(b) Smaller firms may find informal staff meetings highly effective for communicating information relevant to the system of quality management, whereas larger firms may need multiple and more formal mechanisms, such as written communications or webcasts.

#### **Authority of the ISQCs**

109. The ISQCs apply to all firms of professional accountants in respect of audits and reviews of financial statements, and other assurance and related services engagements.

110. The ISQCs contains the objective of the firm in following the ISQCs, and requirements designed to enable the firm to meet that stated objective. In addition, they contains related guidance in the form of application and other explanatory material, as discussed further in paragraph 143, and introductory material that provides context relevant to a proper understanding of the ISQCs, and definitions.

124. The objective provides the context in which the requirements of the ISQC are set, and is intended to assist the firm in:

- Understanding what needs to be accomplished; and
- Determining what needs to be done to achieve the objective.

132. The requirements of the ISQCs are expressed using "shall."

143. Where necessary, the application and other explanatory material provides further explanation of the requirements and guidance for carrying them out. In particular, it may:

- Explain more precisely what a requirement means or is intended to cover; and
- Include examples that may be appropriate in the circumstances.

While such guidance does not in itself impose a requirement, it is relevant to the proper application of the requirements. The application and other explanatory material may also provide background information on matters addressed in the ISQCs. Where appropriate, additional considerations

specific to public sector audit organizations or smaller firms are included within the application and other explanatory material. These additional considerations assist in the application of the requirements in the ~~the~~ ISQCs. They do not, however, limit or reduce the responsibility of the firm to apply and comply with the requirements in the ~~the~~ ISQCs.

154. The ~~the~~ ISQCs includes, under the heading “Definitions,” a description of the meanings attributed to certain terms for purposes of the ~~the~~ ISQCs. These are provided to assist in the consistent application and interpretation of the ~~the~~ ISQCs, and are not intended to override definitions that may be established for other purposes, whether in law, regulation or otherwise. The Glossary of Terms relating to International Standards issued by the IAASB in the *Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements* published by IFAC includes the terms defined in the ~~the~~ ISQCs. It also includes descriptions of other terms found in the ~~the~~ ISQCs to assist in common and consistent interpretation and translation.

### Effective Date

156. Systems of quality management in compliance with this ISQC are required to be established by December 15, 20XX.

### Objective

176. The objective of the firm is to establish and maintain a system of quality management to provide the firm with reasonable assurance that:
- (a) The firm and its personnel comply with professional standards and applicable legal and regulatory requirements; and
  - (b) Reports issued by the firm or engagement partners are appropriate in the circumstances.

### Definitions

187. In this ISQC, the following terms have the meanings attributed below:

- ~~(a) Causal analysis—A process for identifying the underlying cause(s) of an identified deficiency, in order that the underlying cause(s) can be appropriately addressed by the firm.~~
- ~~(ab) Date of report – The date selected by the practitioner to date the report.~~
- ~~(be) Deficiency in the firm’s system of quality management – [Placeholder for further consideration, and also to consider whether to differentiate between varying levels of deficiencies, and how this will flow through into monitoring and remediation, and the firm’s consideration of whether its system of quality management meets the objective of this standard]~~
- ~~(cd) Engagement documentation – The record of work performed, results obtained, and conclusions the practitioner reached (terms such as “working papers” or “work papers” are sometimes used).~~
- ~~(de) Engagement partner<sup>2</sup> – The partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and~~

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<sup>2</sup> “Engagement partner,” “partner,” and “firm” should be read as referring to their public sector equivalents where relevant.

who, where required, has the appropriate authority from a professional, legal or regulatory body.

- (ef) Engagement quality control review – [Refer Agenda Papers for IAASB September 2017 meeting for proposed definition]
- (fg) Engagement quality control reviewer – [Refer Agenda Papers for IAASB September 2017 meeting for proposed definition]
- (gh) Engagement team – All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform procedures on the engagement. This excludes an auditor’s external expert engaged by the firm or by a network firm. The term “engagement team” also excludes individuals within the client’s internal audit function who provide direct assistance on an audit engagement when the external auditor complies with the requirements of ISA 610 (Revised 2013).<sup>3</sup>
- (hi) External inspections – Inspections or investigations of the firm’s system of quality management or engagements performed by the firm that are undertaken by an external oversight authority.
- (ij) Firm – A sole practitioner, partnership or corporation or other entity of professional accountants.
- (jk) Listed entity – An entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body.
- (kl) Monitoring – A process comprising ongoing and periodic evaluations of whether the firm’s system of quality management provides the firm with reasonable assurance that its overall objectives have been achieved.
- (lm) Network firm – A firm or entity that belongs to a network.
- (mn) Network<sup>4</sup> – A larger structure:
  - (i) That is aimed at cooperation, and
  - (ii) That is clearly aimed at profit or cost-sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand name, or a significant part of professional resources.
- (no) Partner – Any individual with authority to bind the firm with respect to the performance of a professional services engagement.
- (op) Personnel – Partners and staff. [To be considered as “staff” includes only professional staff]

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<sup>3</sup> ISA 610 (Revised 2013), *Using the Work of Internal Auditors*, establishes limits on the use of direct assistance. It also acknowledges that the external auditor may be prohibited by law or regulation from obtaining direct assistance from internal auditors. Therefore, the use of direct assistances is restricted to situations where it is permitted.

<sup>4</sup> As defined in the Independent Ethics Standards Board for Accountants (IESBA) *International Code of Ethics for Professional Accountants* (Code)

- (p) Professional standards – IAASB Engagement Standards, as defined in the IAASB's *Preface to the International Quality Control, Auditing, Review, Other Assurance and Related Services Pronouncements*, and relevant ethical requirements.
- (q) Root cause analysis – A process for investigating the underlying cause(s) of an identified deficiency, in order that the underlying cause(s) can be appropriately addressed by the firm.
- (r) Quality objectives – The objectives established by the firm to achieve the firm's overall objective for the firm's system of quality management.
- (s) Quality risk – A risk that, individually or in combination, could reasonably have an adverse impact on the firm's ability to achieve its quality objectives.
- (t) Reasonable assurance – In the context of this ISQC, a high, but not absolute, level of assurance. (Ref. Para A5–A6)
- (u) Relevant ethical requirements – [*To be considered in the context of the IESBA's Restructure Project and whether for purposes of ISQC 1 this should relate to all staff*] Ethical requirements to which the engagement team and engagement quality control reviewer are subject, which ordinarily comprise Parts A and B of the IESBA Code together with national requirements that are more restrictive.
- (v) Remediation – Corrective actions implemented by the firm to address deficiencies identified in the firm's system of quality management.
- (w) Response – The firm's actions to address a quality risk, including policies or procedures.
- (x) Staff – Professionals, other than partners, including any experts the firm employs.
- (y) Suitably qualified external person – [*To be considered in context of how this term has been proposed in relation to engagement quality control reviews, i.e., the engagement quality control reviewer does not need to have the competence and capabilities to act as engagement partner*] An individual outside the firm with the competence and capabilities to act as an engagement partner, for example, a partner of another firm, or an employee (with appropriate experience) of either a professional accountancy body whose members may perform audits and reviews of historical financial information, or other assurance or related services engagements, or of an organization that provides relevant quality control services.

## Requirements

### Applying, and Complying with, Relevant Requirements

- 198. Those assigned ultimate responsibility and accountability for quality, and person(s) within the firm with operational responsibility for the firm's system of quality management, shall have an understanding of the entire text of this ISQC, including its application and other explanatory material, to understand its objective and to apply its requirements properly.
- 2049. The firm shall comply with each requirement of this ISQC unless, in the circumstances of the firm, the requirement is not relevant to the firm. (Ref: Para. A7)
- 210. The requirements are designed to enable the firm to achieve the objective stated in this ISQC. The proper application of the requirements is therefore expected to provide a sufficient basis for the achievement of the objective.

## System of Quality Management

224. The firm shall establish and maintain a system of quality management that includes the following components:

- (a) Governance and leadership, ~~including the organization, culture and strategy of the firm.~~
- (b) Information, communication and documentation.
- (c) A quality management process, that comprises:
  - (i) Establishing quality objectives.
  - (ii) Identifying and assessing quality risks.
  - (iii) Designing and implementing responses to quality risks.
  - (iv) Monitoring and remediation.

## Governance and Leadership, ~~including Organization, Culture and Strategy~~

232. The firm shall establish governance principles in relation to quality and implement them through actions set out in this ISQC, and other actions as appropriate. In establishing the governance principles in relation to quality, the firm shall take into consideration the requirements of law, regulation, or other professional standards in relation to the governance of the firm, if applicable. Such governance principles established by the firm shall include: (Ref. Para A8–A11)

- (a) The firm's internal culture promotes professional and ethical values ~~fosters quality in the conduct of engagements and the expected behavior of personnel at all levels of the firm align with those values; , including professional and ethical values, to support the firm's public interest role;~~ (Ref. Para A12–A145)
- (b) The firm is organized in a manner that supports the effective design, implementation and operation of the firm's system of quality management; (Ref. Para A176–A2048, A234)
- (c) The firm has effective leadership with responsibility and accountability for quality; and (Ref. Para A219–A229)
- (d) The firm takes into account the legitimate and reasonable needs, interests and expectations of relevant stakeholders in formulating decisions ~~enhances stakeholder confidence in the public interest aspects of the firm's decision making~~ in relation to quality, and communicates with external stakeholders, as appropriate. (Ref. Para A286–A297)

243. The firm shall assign ultimate responsibility and accountability for quality to the firm's chief executive officer (or equivalent) or, if appropriate, the firm's managing board of partners (or equivalent). The person(s) assuming such responsibility and accountability shall have sufficient and appropriate experience, knowledge and capacity to assume that responsibility and shall: (Ref: Para. A2149–A229)

- (a) Conduct themselves in a manner that supports ~~promotes~~ the firm's an internal culture that promotes professional and ethical values in the conduct of engagements ~~fosters quality, including professional and ethical values, to support the firm's public interest role, including and~~ taking actions to establish and extend that culture throughout the firm; (Ref: Para. A12–A13)

- (b) Establish a business strategy that reflects the professional and ethical values of the firm, recognizes the need for the firm to achieve quality in all engagements, ~~supports the firm's public interest role~~ and recognizes that commercial considerations do not override the quality of work performed; (Ref: Para. A154–A16)
  - (c) Establish an organizational structure that supports the effective design, implementation and operation of the firm's system of quality management; (Ref: Para. A176–A2018, A231)
  - (d) Establish the necessary resources and allocate such resources appropriately, in order to support the design, implementation and operation of the firm's system of quality management and the performance of engagements and allocate these appropriately; and (Ref: Para. A264–A275)
  - (e) Promote the consideration of the legitimate and reasonable needs, interests and expectations of ~~relevant~~ stakeholders in formulating decisions in relation to quality and communicate with external stakeholders, as appropriate. (Ref: Para. A286–A297)
254. Any person(s) that are assigned operational responsibility for the firm's system of quality management shall ~~also have~~: (Ref: Para. A232–A253)
- (a) ~~s~~Sufficient and appropriate experience, knowledge and capacity to assume that responsibility;  
and
  - (b) A reporting line of communication to person(s) assigned ultimate responsibility and accountability for quality. (Ref: Para. A22–A23)
265. The firm shall establish policies or procedures for periodic performance evaluations that assess the effectiveness of:
- (a) The person(s) that are assigned ultimate responsibility or accountability for quality; and
  - (b) Any person(s) that are assigned operational responsibility for the firm's system of quality management.
- The firm shall respond to the results of such performance evaluations ~~implement corrective actions to address performance issues that are identified through performance evaluations and which may affect that are relevant to~~ the firm's achievement of its quality objectives. (Ref: Para. A11, A3028–A3129)

#### Whistleblowing

276. The firm shall establish policies or procedures that: (Ref: Para. A320–A353)
- (a) Enable reporting by the firm, its personnel or external parties, without fear of reprisal, of concerns in relation to the commitment to quality of the firm or its personnel, without fear of reprisal; and
  - (b) Enable the investigation of concerns raised by the firm, its personnel or external parties.
287. If during the investigations into concerns, deficiencies in the design, implementation or operation of the firm's system of quality management are identified, the firm shall ~~determine and evaluate~~ investigate the root cause(s) of the deficiencies and implement remedial actions. (Ref: Para. A364–A375)

## Information, Communication and Documentation

### Information and Communication

~~298.~~ The firm shall obtain, or generate, and communicate appropriate information necessary to enable and support the proper functioning of the firm's system of quality management, including information: (Ref: Para. A386–A397, A432 and, A475–A48 and A46)

- (a) In relation to the firm's system of quality management that is relevant to engagement teams, in order that engagement teams have the information necessary to perform the engagement; and (Ref Para. A4038)
- (b) That is relevant to personnel performing functions in relation to the operation of the firm's system of quality management, in order that such personnel are able to fulfill their responsibilities in relation to such roles, including those who are ultimately responsible and accountable for quality; and (Ref: Para. A4139–A420)

~~Exchanged with parties that are external to the firm. (Ref: Para. A41)~~

In doing so, the firm shall establish policies or procedures that facilitate ~~two-way~~ the communication of such information with relevant parties that enables the firm and relevant parties to take appropriate and timely action in relation to such information. (Ref: Para. A44 and 3–A464)

~~30. The firm shall exchange information with parties that are external to the firm that is necessary to enable and support the proper functioning of the firm's system of quality management, or that is required to be communicated by law, regulation or relevant ethical requirements. (Ref: Para. A45–A464)~~

### Documentation

~~3129.~~ [Please refer to Agenda Item 7 of the September 2017 meeting regarding the proposals in relation to documentation]

## Quality Management Process (Ref: Para. A497)

### Establish Quality Objectives

~~329.~~ The firm shall establish quality objectives necessary to achieve the overall objective of the firm's system of quality management, ~~that include:~~ (Ref: Para. A5048–, A532 and A53)

- (a) The firm, its personnel and, where applicable, others subject to relevant ethical requirements (including network firm personnel, as applicable) fulfill relevant ethical requirements.
- (b) The firm accepts and continues client relationships and specific engagements for which the firm is:
  - (i) Satisfied with the integrity and ethical values of management, and, when appropriate, those charged with governance; and
  - (ii) Able to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements.
- (c) The firm has sufficient and appropriate resources, including financial resources, human resources, ~~technological~~ resources, and intellectual resources, that are suitably used or allocated in order to:

- (i) Support the functioning of the firm's system of quality management;
  - (ii) Perform engagements in accordance with professional standards and applicable legal and regulatory requirements; and
  - (iii) Promote consistency in the quality of engagement performance.
- (d) The firm and its personnel achieve the objective of managing quality at the engagement level, including performing engagements in accordance with professional standards and applicable legal and regulatory requirements and issuing reports that are appropriate in the circumstances.

~~334. In establishing its quality objectives, the firm shall consider whether the quality objectives are set at an appropriate level of granularity, or whether additional quality objectives are necessary, in order to appropriately reflect the circumstances of the firm, including the nature of engagements performed by the firm, and to enable the firm to identify and assess the quality risks. In establishing the quality objectives, the firm shall also consider whether:~~

~~(a) The quality objectives are aligned with the firm's governance principles and strategy, professional standards and applicable legal and regulatory requirements. (Ref: Para. A50–A53); (Ref: Para. A50)~~

~~(b) The quality objectives are relevant to the circumstances of the firm and all relevant quality objectives have been identified; and (Ref: Para. A51–A52)~~

~~(c) The quality objectives are set at an appropriate level of granularity that enables the firm to identify and assess the quality risks. (Ref: Para. A49)~~

~~32. The quality objectives established by the firm shall be based on the following:~~

*[Quality objectives presented to the IAASB at the August 2017 teleconference, now included in paragraph 32 above.]*

#### *Perform Quality Risk Assessment*

~~343.~~ The firm shall identify quality risks, through understanding the conditions, events, circumstances, actions or inactions that, individually or in combination, could reasonably have an adverse impact on the firm's ability to achieve its quality objectives. (Ref: Para. A54–A57~~8~~)

~~354.~~ The firm shall assess the likelihood and impact of the quality risks identified in paragraph ~~343~~. (Ref: Para. A58~~9~~)

~~365.~~ The quality risks shall include the following: (Ref: Para. A59)

- (a) The firm, its personnel and, when applicable, others subject to relevant ethical requirements (including network firm personnel, as applicable) do not fulfill relevant ethical requirements, including independence requirements, including as a result of:
  - (i) Insufficient understanding of relevant ethical requirements, including in relation to:
    - Circumstances that may cause a breach of independence;
    - Their responsibilities in relation to circumstances where there is non-compliance with laws and regulations;
  - (ii) A failure to:

- Identify threats to compliance with the principles of the relevant ethical requirements, including the independence requirements;
  - Evaluate the threats identified;
  - Address the threats by eliminating or reducing them to an acceptable level, by applying safeguards, declining the engagement or, if considered appropriate, withdrawing from the engagement, when withdrawal is possible under applicable law or regulation; or
  - Evaluate whether the actions taken to address the threats to compliance with the fundamental principles have eliminated those threats or reduced them to an acceptable level.
- (b) The firm accepts or continues a client relationship or specific engagement, in circumstances when management, and, when appropriate, those charged with governance, lack integrity and ethical values, including as a result of a failure to obtain or generate and communicate information to support the firm's consideration of the integrity and ethical values.
- (c) In accepting or continuing a client relationship or specific engagement, the firm does not assess its ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements.
- (d) The firm does not obtain the acknowledgement and understanding by management, and, when appropriate, those charged with governance, of their responsibilities in relation to the engagement.
- (e) The firm does not determine whether there is, or will be, appropriate access to the information that is necessary to be able to perform the engagement.
- (f) The firm does not appropriately consider, or respond appropriately, in circumstances when the firm becomes aware of information that:
- (i) Would have caused it to decline an engagement had that information been available prior to accepting or continuing a client relationship or specific engagement; or
  - (ii) Affects the firm's decision to continue a client relationship or specific engagement.
- (g) *[Placeholder – additional quality risks related to financial resources, human resources, technological resources and intellectual resources need to be further developed]*
- (h) The firm does not attract, develop or retain human resources that have:
- (i) Sufficient capacity to effectively support the functioning of the firm's system of quality management and perform quality engagements;
  - (ii) Appropriate competence and experience to perform engagements, including knowledge or experience regarding:
    - The professional standards, including relevant ethical requirements, and applicable law or regulation in relation to the engagement being performed;
    - The industry in which the entity operates;
    - The underlying subject matter or the criteria to be applied in the preparation of the subject matter information; or

- (iii) Competence and experience to perform functions in relation to the operation of the firm's system of quality management.
- (i) The firm does not undertake performance evaluations or establish compensation and promotion mechanisms that incentivize the maintenance and development of the competence and experience of firm personnel, including those performing engagements.
- (j) Quality at the engagement level is not achieved, as a result of a failure by the firm to:
  - (i) Assign responsibility and authority for each engagement to an engagement partner and clearly define and communicate such responsibilities;
  - (ii) Determine and communicate responsibilities in relation to engagements, including responsibilities in relation to:
    - Adequate direction and supervision of the engagement team and review of the work of the engagement team;
    - The appropriate review by more experienced engagement team members of work performed by less experienced team members;
  - (iii) Provide appropriate consultation on difficult or contentious matters or to determine responsibilities in relation to consultations, including the agreement and implementation of conclusions resulting from consultations;
  - (iv) Deal with or resolve differences of opinion that may arise within the engagement team, with the engagement quality control reviewer or with personnel performing functions in relation to the operation of the firm's system of quality management, including those who provide consultation; or
  - (v) Establish an appropriate period of time for the assembly of engagement files after the engagement reports have been finalized and address the retention and maintenance of engagement documentation to meet the needs of the firm and to comply with law, regulation, relevant ethical requirements, or other professional standards.

#### *Design and Implement Responses to Quality Risks*

**376.** Taking into account the assessed likelihood and impact of the quality risks, the firm shall design and implement responses for which the nature, timing and extent are responsive to the conditions, events, circumstances, actions or inactions that gave rise to the quality risks. (Ref: Para. A60–A70)

**387.** The responses shall include the following:

*[Certain responses will be prescribed, but will be limited. One of the prescribed responses will include performing engagement quality control reviews in relation to certain engagements. Please refer to Agenda Item 3 of the September 2017 meeting regarding the proposals in relation to engagement quality control reviews.]*

## Monitoring and Remediation

### Establishing a Monitoring and Remediation Process

~~398~~. The firm shall establish a monitoring and remediation process in order to evaluate whether the firm's system of quality management provides the firm with reasonable assurance that ~~theits~~ overall objective has been achieved. (Ref: Para. A71–A72)

### Monitoring the Firm's System of Quality Management

~~4039~~. The firm shall design and perform monitoring activities that are sufficient to provide the firm with an evaluation of whether the system of quality management provides the firm with reasonable assurance that the overall objective has been achieved, including whether: (Ref: Para. A73)

- (a) The governance principles in relation to quality have been implemented and the firm's leadership has assumed ultimate responsibility and accountability for quality;
- (b) The firm's information and communication policies or procedures enable and support the proper functioning of the firm's system of quality management;
- (c) The quality management process of the firm includes appropriate quality objectives and is appropriately identifying, assessing, and responding to the quality risks; and
- (d) The firm's monitoring and remediation process appropriately enables the evaluation of the firm's system of quality management.

~~419~~. The firm shall determine the scope and frequency of the monitoring activities, taking into consideration: (Ref: Para. A74–A8~~19~~)

- (a) The design and implementation of the firm's system of quality management;
- (b) Changes in factors that have impacted the firm's system of quality management;
- (c) The results of previous monitoring activities and remedial actions, including whether the previous monitoring activities continue to be relevant in evaluating the firm's system of quality management; and
- (d) Other information that may suggest deficiencies exist in the firm's system of quality management, including information from external inspections that may indicate the need for the firm to conduct monitoring activities, or circumstances related to a material restatement of financial statements or a report requiring reissuance.

~~424~~. As part of the monitoring activities, the firm shall establish policies or procedures requiring the inspection of completed engagements. Such policies or procedures shall set out criteria for the selection of completed engagements for inspection that sufficiently support the firm in its evaluation of its system of quality management. Such criteria shall include the inspection of at least one completed engagement for each engagement partner on a cyclical basis determined by the firm. (Ref: Para. A8~~24~~–A8~~43~~)

~~432~~. The firm shall:

- (a) Assign operational responsibility for the monitoring process to a partner or partners or other persons with sufficient and appropriate experience and authority in the firm to assume that responsibility and who has a reporting line of communication to the person(s) assigned ultimate responsibility and accountability for quality; and

- (b) Determine that those performing the monitoring activities have sufficient and appropriate experience, knowledge and capacity to perform the monitoring activity and are sufficiently objective from the activity subject to monitoring. (Ref: Para. A854–A865)

#### Identifying and Remediating Identified Deficiencies

*[Further deliberations of the QCTF on this section will include clarification of what is considered to be a deficiency and how this relates to the root cause analysis and evaluation of the firm's system of quality management.]*

- 443. The firm shall assess the results of the monitoring activities and external inspections, in order to: (Ref: Para. A876–A9088)
  - (a) Identify deficiencies in the firm's system of quality management;
  - (b) ~~Determine-Investigate~~ the root cause(s) of deficiencies and evaluate their effect; and
  - (c) Implement appropriate remedial actions.
- 454. In circumstances when a deficiency identified relates to an engagement and there is an indication that the report may be inappropriate or that procedures were omitted during the performance of the engagement, the firm shall:
  - (a) Determine what further action is necessary to comply with relevant professional standards and applicable legal and regulatory requirements; and
  - (b) Consider whether to obtain legal advice.
- 465. The firm shall ~~investigatedetermine~~ the root cause(s) of deficiencies. The nature, timing and extent of the procedures undertaken by the firm to ~~investigatedetermine~~ the root cause(s) of deficiencies shall be determined by the firm based on the nature of the deficiencies. (Ref: Para. A9189–A964)
- 476. The firm shall evaluate the effect(s) of deficiencies, taking into account the identified root cause(s). In doing so the firm shall:
  - (a) Determine whether the root cause(s) are systemic, repetitive or other root causes that require timely remedial action.
  - (b) Consider the continued relevance of the firm's quality objectives, whether all quality risks have been identified and appropriately assessed and whether the responses to quality risks remain appropriate. (Ref: Para. A975)
- 487. The firm shall implement remedial actions, as appropriate, that are responsive to the root cause(s) of deficiencies and the related effect(s). (Ref: Para. A986)

#### Assessing the Effectiveness of the Monitoring and Remediation Process

- 498. The firm, including those assigned ultimate responsibility and accountability for quality, shall monitor the effectiveness of the remedial actions designed and implemented to address the root cause(s) and evaluate whether the remedial actions appropriately address the deficiencies identified. (Ref: Para. A997)

## Communicating Matters Related to Monitoring and Remediation

**5049.** The firm shall communicate, on a timely basis or at least annually, relevant information about the results of the firm's monitoring and remediation to engagement teams, personnel performing functions in relation to the operation of the firm's system of quality management, including those who are ultimately responsible and accountable for quality, and parties that are external to the firm, as appropriate, unless prohibited by law or regulation. Information communicated shall include the following: (Ref: Para. A4~~29~~, A~~10098~~–A~~10299~~)

- (a) A description of the monitoring procedures performed.
- (b) Information about deficiencies, the root cause(s) of such deficiencies and remedial actions.
- (c) The conclusions drawn from monitoring and remediation.

## Considerations Relating to Networks

**519.** [*Placeholder – networks to be further considered*] Some firms operate as part of a network and, for consistency, may implement some of their monitoring procedures on a network basis. Where firms within a network operate under common monitoring policies or procedures designed to comply with this ISQC, and these firms place reliance on such a monitoring system, the firm's policies or procedures shall require that:

- (a) At least annually, the network communicate the overall scope, extent and results of the monitoring process to appropriate individuals within the network firms; and
- (b) The network communicate promptly any identified deficiencies in the system of quality control to appropriate individuals within the relevant network firm or firms so that the necessary action can be taken,

in order that engagement partners in the network firms can rely on the results of the monitoring process implemented within the network, unless the firms or the network advise otherwise.

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## Application and Other Explanatory Material

### The Firm's System of Quality Management (Ref: Para. 3–8)

- A1. Governance principles form the framework for how the firm's decisions are made and therefore promote an environment that sustains and improves quality. Firm leadership has ultimate responsibility for quality and is accountable to the firm and the firm's stakeholders for the firm's quality. Nevertheless, firm leadership may assign responsibility for aspects of the firm's system of quality management to other individuals within the firm, which may include operational responsibility for the firm's system of quality management.
- A2. Information and communication is the continual, iterative process of obtaining or generating and communicating information necessary to enable and support the proper functioning of the firm's system of quality management. Information and communication is necessary for all components of the firm's system of quality management, including governance and leadership and the firm's quality management process.

- A3. The firm's quality management process encompasses the ongoing activities that support a risk-based approach to managing quality in the context of the overall objective in paragraph 176. These activities are interrelated and include the firm's monitoring of its system of quality management, which promotes the continual improvement of the firm's system of quality management. Such monitoring activities also include monitoring of the firm's governance and leadership and information and communication.
- A4. Other pronouncements of the IAASB, for example ISA 220, ISRE 2400 (Revised)<sup>5</sup> and ISAE 3000 (Revised),<sup>6</sup> establish requirements for the engagement partner in relation to the management of quality at the engagement level that include ~~managing risks to quality and~~ implementing the firm's responses to quality risks at an engagement level. Furthermore, ISA 220 establishes requirements for the engagement partner to consider whether ~~there are other risks to quality and to identify additional~~ responses to the firm-level responses are necessary in order to appropriately to manage engagement quality at the engagement level.

## Definitions

*Reasonable Assurance* (Ref: Para. 187(t))

- A5. Reasonable assurance is a high level of assurance and is obtained when the firm's system of quality management ~~is effective in reducing~~ the risk that the firm does not achieve ~~its overall quality objective, that is,~~ the objective of this ISQC set forth in paragraph 16 to an acceptably low level. However, the firm is not required to obtain an absolute level of assurance, because there are inherent limitations of a firm's system of quality management. Such limitations include the reality that human judgment in decision-making can be faulty and that breakdowns in the firm's system of quality management may occur because of human error or behavior. The components of the system of quality management, operating together, reduce the risk of not achieving the overall objective to an acceptably low level, i.e., the firm is not required to establish reasonable assurance in relation to each of the components individually.
- A6. When deficiencies are identified, this ISQC requires the firm to implement remedial actions to address the deficiencies identified, thereby providing the firm with reasonable assurance that it has achieved the overall objective in paragraph 176. Nevertheless, the identification of deficiencies within the firm's system of quality management may not necessarily indicate that the firm's system of quality management is not achieving its objective because the concept of reasonable assurance recognizes that some ~~deficiencies~~ violations in the firm's system of quality management may occur, for example:
- An identified deficiency may not be pervasive to all engagements (i.e., it is limited to a single engagement) and therefore may still provide the firm with reasonable assurance that the overall objective of its system of quality management has been achieved.
  - Although a deficiency may have been identified in relation to a firm's response to a quality risk, the firm may have other responses that have been implemented to address the same quality risk for which no deficiencies have been identified.

## Applying, and Complying with, Relevant Requirements (Ref: Para. 2049)

<sup>5</sup> International Standard on Review Engagements (ISRE) 2400 (Revised), *Engagements to Review Historical Financial Statements*

<sup>6</sup> International Standard on Assurance Engagements (ISAE) 3000, *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*

- A7. This ISQC does not call for compliance with requirements that are not relevant. For example, in the circumstances of a sole practitioner with no staff, ~~the R~~ requirements in this ISQC in relation to the following may not be relevant due to the absence of staff:
- Communicating appropriate information necessary to enable and support the proper functioning of the firm's system of quality management, including communicating matters in relation to monitoring and remediation.
  - Establishing a whistleblowing process that enables reporting, without fear of reprisal, of concerns in relation to the commitment to quality of the firm or its personnel.
  - Establishing an organizational structure and assigning responsibility, for example, operational responsibility for the system of quality management or operational responsibility for monitoring and remediation.
  - Undertaking periodic performance evaluations that assess the effectiveness of firm leadership, such as those for policies or procedures for the assignment of appropriate personnel to the engagement team (see paragraph XX), for review responsibilities (see paragraph XX), and for the communication of the results of monitoring within the firm (see paragraph 49) are not relevant in the absence of staff.

**Governance and Leadership, including Organization, Culture and Strategy** (Ref: Para. ~~232–287~~)

- A8. The governance principles in paragraph ~~232~~ are relevant to all firms and form the framework for how the firm's decisions take into account the overall objective of quality. In addition, law, ~~or~~ regulation or other professional standards may prescribe additional matters related to the governance of the firm~~how the firm is governed~~, for example, the firm may be required to follow an audit firm governance code that may incorporate more specific governance principles and require adherence to specific provisions. The firm may also establish governance principles that are more specific than the governance principles set out in paragraph ~~232~~. In establishing governance principles in relation to quality, the firm may take into consideration a variety of factors, including:

*[Factors to be further developed by the QCTF, for example, in relation to external factors, the influence of the regulatory environment on the quality of certain of the firm's services, and in relation to internal factors, the size and diversity of services provided by the firm.]*

- A9. The firm's actions to implement the principles in relation to the governance of the firm may include establishing policies or procedures, assigning responsibility, communicating, providing training, or establishing resources. Paragraph ~~243~~ requires the firm to assign ultimate responsibility and accountability for quality to firm leadership and further requires firm leadership to take actions that address each of the principles in relation to the governance of the firm. Furthermore, paragraphs A12–A~~37~~~~5~~ include examples of other actions the firm may implement to address such principles and through the quality management process, the firm may implement responses that also address the principles. For example, the firm's responses in relation to compliance with relevant ethical requirements may assist the firm in embedding the firm's internal culture, in particular the professional and ethical values.
- A10. The quality objectives, quality risks and responses to the quality risks that are established by the firm, as required by paragraphs ~~320–387~~, reflect the circumstances of the firm and therefore may change as a result of decisions made by the firm. For example, the firm's decision in relation to the organization of the firm or the allocation of resources may affect the identified and assessed quality

risks or the responses that have been designed and implemented to address those quality risks. Accordingly, the results of decisions made by the firm, which are influenced by the firm's governance principles, may be a necessary and ongoing input into the firm's quality management process.

- A11. In accordance with paragraph ~~4039~~, the firm's monitoring activities include an evaluation of the implementation of the governance principles in relation to quality and whether the firm's leadership has assumed ultimate responsibility and accountability for quality. Paragraph ~~265~~ also establishes requirements in relation to periodic performance evaluations of individual(s) within the firm, which may form part of such monitoring activities.

*Internal Culture* (Ref: Para. ~~232(a) and 243(a), and 23(b)~~)

- A12. Internal culture embodies the attitudes, values and behaviors exhibited by the firm and its personnel in its operations and interactions with its stakeholders. It is developed over time through beliefs, customs and rules. The firm's internal culture is an important factor in influencing how its personnel function ~~in performing engagements in the interests of the public~~, while at the same time accomplishing the firm's commercial goals. A firm with a quality-focused culture recognizes and reinforces the importance of professional and ethical ~~attitudes, values, which influence attitudes~~ and behaviors, and has a philosophy of accountability, transparency and continual improvement.
- A13. Establishing an internal culture that ~~promotes the conduct of quality engagements fosters quality~~ depends on clear, consistent, frequent and effective actions, including communication, at all levels within the firm that emphasize the firm's commitment to quality. The firm's ~~chief executive officer (or equivalent) or the firm's managing board of partners (or equivalent) leadership~~, sets the tone at the top and the attitude to quality, including professional and ethical values, ~~to support the firm's public interest role~~, through their operating style and personal conduct. This is further shaped and reinforced through the embracement by the firm's personnel of their role in embedding or demonstrating the ~~desired-expected professional and ethical~~ behaviors that confirm the firm's commitment to quality. The actions undertaken by those assigned ultimate responsibility and accountability for quality to foster a culture of quality throughout the firm may include:
- Defining the purpose and ethical values of the firm, as well as the expected behaviors of the firm's personnel.
  - Establishing trust through consistent, regular and open communication within the firm and through establishing policies or procedures to deal with complaints and allegations (i.e., whistleblowing).
  - Establishing responsibility and accountability for quality, for example, through clearly defining and communicating roles and responsibilities throughout the firm and defining how internal quality will be measured.
  - Providing transparency within the firm about the firm's actions to address quality, and the effectiveness of those actions.
  - Establishing policies or procedures to address recruitment, development, compensation, and promotion with regard to its personnel that support and encourage behaviors that are consistent with the firm's purpose, values and strategy.

- Establishing appraisal and reward systems that promote personal characteristics that support and reinforce the firm's view on the importance of quality, and providing personnel with continuing professional development opportunities.
- Promoting a culture of consultation on difficult issues and providing access to high-quality technical support.
- Implementing robust systems for supporting decisions about the acceptance and continuance of client relationships and specific engagements.
- Monitoring the effectiveness of actions implemented to embed the culture and evaluating whether the outcome of monitoring activities are reflective of an internal culture that focuses on professional and ethical values and the performance of quality engagements on quality and the firm's public interest role.

The extent of such actions may depend on a variety of factors, including the size, structure, geographical dispersion and complexity of the firm. For example, a smaller firm may be able to influence the desired culture through less extensive actions due to the close interaction of firm leadership with the firm's personnel.

A145. The firm may carry out other actions to emphasize that each individual within the firm has a personal responsibility for quality and is expected to comply with the firm's policies or procedures.

Strategy (Ref: Para. 24(b))

A154. Those assigned ultimate responsibility and accountability for quality also establish the firm's internal culture through the business strategy. A business strategy that aims to achieve an appropriate balance between long term sustainability and the need for the firm to achieve quality in all engagements recognizes that commercial considerations should not result in actions and decisions that impair quality. Commercial considerations that may impair quality may include excessive cost-cutting at times of economic downturn that damage the provision of quality in the medium term or internal training that is disproportionately focused on improving client service at the expense of necessary training to develop technical competence.

A16. [Additional application material to be developed to emphasize the importance of understanding the firm and its environment in developing the strategy, for example, in the circumstance of a network or when the firm makes use of alternative delivery models.]

~~A15. The firm may carry out other actions to emphasize that each individual within the firm has a personal responsibility for quality and is expected to comply with the firm's policies or procedures.~~

Organization of the Firm (Ref: Para. 232(b) and 243(c))

A176. Organizing the firm in a manner that supports the effective design, implementation and operation of the firm's system of quality management may include:

- Establishing an internal firm structure that is commensurate with the size and operating characteristics of the firm and the services the firm provides;
- Designating authority and responsibility within the firm; and
- Maintaining and allocating sufficient and appropriate resources.

## Internal Firm Structure

A187. The firm's internal structure comprises the leadership and management structure of the firm as well as how the firm is organized into divisions or geographical locations. The firm's leadership may ~~be~~ comprised ~~of~~ a chief executive officer (or equivalent), managing board of partners (or equivalent) or other person(s). In some circumstances, the firm may also have an independent governing body or board of partners that has executive oversight of the firm, or committees may be established to fulfill specific leadership functions. At a jurisdictional level, law or regulation may prescribe the leadership and management structure ~~or composition of the~~ firm ~~leadership~~, for example, certain jurisdictions mandate the appointment of a governing body comprising a minimum number of independent non-executive members and prescribe the function or responsibilities of those appointed within these roles. Smaller firms may have simple structures comprising a single partner with responsibility for the oversight of the firm.

A198. In establishing the firm's leadership and management structure, the firm may take into consideration:

- The required knowledge, experience and capacity necessary to fulfill the identified roles; and
- The need for other attributes that contribute to the firm's commitment to improved quality, for example, appointing individual(s) who are independent to the board of partners or who are not involved in the operational aspects of the firm and are therefore able to provide impartial judgment in the firm's decision-making, that takes into consideration the legitimate and reasonable needs of relevant stakeholders that enhances the firm's recognition of its public interest role and its commitment to quality.

A20. The organization of the firm may include structures to provide the necessary resources to support the firm's system of quality management and engagement teams in the performance of quality engagements. For example, the firm may organize its structure to include alternative delivery models, such as a shared service center, center of excellence, on-shoring, offshoring or outsourcing.

Responsibility, Accountability and Authority (Ref: Para. 232(c) and 243)

A2149. Firm leadership is allocated ultimate responsibility for quality and is accountable to the firm and the firm's stakeholders for the firm's quality. Identifying those who are ultimately responsible and accountable for quality depends on the circumstances of the firm and may also be influenced by jurisdictional requirements in relation to how the firm is structured. In some circumstances ~~when the firm appoints a managing board of partners (or equivalent)~~, the managing board of partners (or equivalent) may have responsibility for overseeing the firm's operations and allocating resources, and therefore it may be appropriate for such managing board of partners (or equivalent) to have ~~has~~ a shared responsibility and accountability for quality. In the case of a smaller firm, there may be an individual partner who has ultimate responsibility and accountability for quality.

A220. Accountability for quality may be established through various actions, including evaluating whether the quality management system achieves its overall objective. Communication of relevant information about the results of the firm's monitoring and remediation to those assigned ultimate responsibility and accountability for quality, as required by paragraph 5049, supports the accountability of firm leadership for quality, since firm leadership has the responsibility to take prompt and appropriate action, where necessary, in response to such information. Paragraph 498 also requires those assigned ultimate responsibility and accountability for quality to monitor the effectiveness of the remedial actions designed and implemented to address the root cause(s) of deficiencies and to

evaluate whether the remedial actions appropriately address the deficiencies identified. The remedial actions to address root causes(s) of deficiencies may relate to the design, implementation or operation of the firm's system of quality management, including the continued relevance of the firm's quality objectives, whether all quality risks have been identified and appropriately assessed and whether the responses to the risks remain appropriate.

Assigning operational responsibility for the firm's system of quality management (Ref: Para. 232(b), 243(c), and 254)

~~A231. Assigning operational responsibility for the firm's system of quality management establishes the authority of the person(s) to whom responsibility is assigned and facilitates decision-making within appropriate boundaries.~~ Clearly communicating reporting lines, roles, authority and responsibilities to the firm's personnel supports those assigned operational ~~such~~ responsibility for the firm's system of quality management in performing their functions and establishes their accountability. Depending on the geographical dispersion, size, structure and complexity of the firm, the firm may determine it more effective to centralize responsibility for certain functions to achieve a desired level of consistency. However, in other cases the firm may determine that decentralizing such responsibilities is more effective.

A242. Sufficient and appropriate experience and knowledge enables the person(s) assigned operational responsibility for the firm's system of quality management to identify and understand quality management issues and to establish quality objectives, identify and assess quality risks and design and implement appropriate responses. Furthermore, it is necessary that the person(s) have sufficient time to adequately discharge their responsibilities.

A253. The accountability of those assigned operational responsibility for the firm's system of quality management is established through periodic performance evaluations that assess their effectiveness, as required by paragraph 265, and may be further established by:

- ~~• Clearly communicating roles, authority and responsibilities within the firm in order that personnel understand their function and the firm's expectations.~~
- Providing incentives for actions to be implemented through monitoring the firm's system of quality management, including:
  - Pre-defining internal quality measures, and evaluating such measures against targets.
  - Evaluating the effectiveness of the firm's process for establishing quality objectives and identifying and assessing quality risks.
  - Evaluating whether the firm's responses to the quality risks appropriately address the quality risks.
- Establishing appraisal and reward systems that address the responsibilities and promote personal characteristics that support and reinforce the firm's view on the importance of quality.

Resources (Ref: Para. 243(d))

A264. Establishing the necessary resources and allocating these appropriately is essential for the proper functioning of the firm's system of quality management and supporting the performance of the firm's engagements. Resources include:

- Financial resources that are available to the firm.
- Human resources who have appropriate competence and capabilities.
- Technologically resources, for example, application systems and hardware.
- Intellectual resources, for example, the firm's development of a methodology or guides.

A275. Those assigned ultimate responsibility and accountability for quality are in a unique position to influence the extent of resources that the firm obtains and maintains, and how the firm's resources are allocated. Paragraphs ~~32 and 36XX, respectively,~~ includes additional requirements regarding the firm's quality objectives and, quality risks and responses that addressing resources.

Stakeholders Confidence (Ref: Para. ~~232~~(d) and ~~243~~(e))

A286. The firm may have a variety of stakeholders, including the network or other network firms, audit oversight bodies and other external bodies, those charged with governance of the firm's clients or users of the firm's reports. ~~In enhancing stakeholder confidence in the public interest aspects of the firm's decision making, the firm takes into account the legitimate and reasonable needs, interests and expectations of all stakeholders in formulating decisions, i.e.,~~ In the firm's decision-making in relation to quality, the firm considers the interests of its stakeholders, in addition to considering what is in the best interests of the firm, ~~the firm also gives consideration to its stakeholders.~~ This supports the firm's recognition of its professional and ethical values in the conduct of engagements-public interest role. In the case of a smaller firm, the extent of stakeholders may be more limited depending on the nature of engagements undertaken by the firm and the entities for which such engagements are performed.

A297. Stakeholders' perception of the quality of engagements performed by the firm may be improved when they consider that the firm supports and embeds a quality-focused culture that emphasizes ~~the professional and ethical values in the conduct of engagements~~ firm's public interest role. Confidence may be increased if stakeholders are made aware of the firm's activities that it has undertaken to address quality, and the effectiveness of those actions. As a result, the firm's ability to maintain stakeholder confidence in the quality of its engagements may be enhanced through effective two-way communication between the firm and its stakeholders. How the firm effects such communication may vary, for example, the firm may assign responsibility for stakeholder communication to a governing body who ~~is~~ are able to independently initiate dialogue with the firm's stakeholders and prompt feedback in a manner that facilitates candid discussion. In some circumstances, the firm may communicate with stakeholders through a transparency report. Paragraph XX addresses circumstances when the firm is required to prepare a transparency report. [*Placeholder for when transparency reporting is further developed*]. In the case of a smaller firm, there may not be a need to communicate with stakeholders in this manner.

Performance Evaluations (Ref: Para. ~~265~~)

A3028. Firm leadership's accountability for quality is also established by evaluating the effectiveness of firm leadership overall, as well as the performance of individuals within firm leadership. Paragraph ~~265~~ requires the firm to establish ongoing performance evaluations that assess the effectiveness of the person(s) that are assigned ultimate responsibility and accountability for quality. Given the unique position of firm leadership, such evaluations may be undertaken by an independent non-executive member of the firm's governing body, a special committee, or an external service provider.

A3129. Undertaking periodic performance evaluations of individual(s) within the firm supports the firm's evaluation of whether the governance principles in relation to quality have been implemented through appropriate actions and whether the firm's leadership has assumed ultimate responsibility and accountability for quality, as required by paragraph 4039.

[Placeholder for additional application material related to performance evaluations that may include:

- Specific consideration of the firm's monitoring results and the effective operation of the quality management process.
- Measuring performance against the leadership responsibilities in paragraph 243.]

*Whistleblowing* (Ref: Para. 276–287)

A320. Establishing policies or procedures to deal with whistleblowing (i.e., complaints and allegations) supports the firm's internal culture of fostering quality and ethical values. The firm's process to enable reporting of complaints and allegations may include establishing clearly defined channels for firm personnel or external parties to raise any concerns in a manner that enables them to come forward without fear of reprisals.

A334. Complaints and allegations (which do not include those that are clearly frivolous) may originate from within or outside the firm and may relate to the failure of the work performed by the firm to comply with professional standards and applicable legal and regulatory requirements, or non-compliance with the firm's system of quality management. Complaints and allegations could be made by engagement team members, other firm personnel, clients or other third parties.

A342. Policies or procedures established for the investigation of complaints and allegations may include, for example, that the person(s) supervising the investigation:

- Has sufficient and appropriate experience;
- Has authority within the firm; and
- Is otherwise not involved in the engagement or has sufficient objectivity from the area or personnel of the firm subject to the investigation.

The person(s) supervising the investigation may involve legal counsel as necessary. In the case of a small firm, it may not be practicable for the partner supervising the investigation not to be involved in the engagement or other subject matter of the investigation. As a result, such firms may use the services of a suitably qualified external person or another firm to carry out the investigation into complaints and allegations.

A353. In investigating complaints and allegations, the firm may have a responsibility to determine whether law, regulation or relevant ethical requirements impose an obligation on the firm to report the matter to an authority outside the firm.

A364. Paragraphs 454–498 explain the actions that may be taken by the firm to address deficiencies in the design, implementation or operation of the firm's system of quality management. Such actions include consideration of the continued relevance of the firm's quality objectives, whether all quality risks have been identified and appropriately assessed and whether the responses to quality risks remain appropriate. Furthermore, the firm may monitor the effectiveness of the remedial actions designed and implemented to address the root cause(s) of deficiencies.

A375. If the firm operates as part of a network, there may be circumstances when the firm may determine it appropriate to report a complaint or allegation in relation to another network firm, for example, the firm may identify an error in the methodology developed by the network firm. In such circumstances, the remedial actions taken by the firm may include determining whether the network firm has taken appropriate remedial action and monitoring the effectiveness of such actions.

## Information, Communication and Documentation

*Information and Communication* (Ref: Para. 29–308 and 5049)

A386. Obtaining or generating and communicating information is an ongoing process that involves all firm personnel and encompasses the dissemination of information within the firm and externally. Information that is relevant, accurate, complete, timely and valid is necessary for the proper functioning of the firm's system of quality management, and may be obtained from both internal and external sources.

A397. Communication is the means through which the firm and its personnel share relevant information to support the proper functioning of the firm's system of quality management. Paragraph 298 identifies the parties with whom communication is required, which may include communication among those parties, and may include external parties. For example, personnel performing functions in relation to the operation of the firm's system of quality management may obtain information in relation to external inspection findings from an external oversight authority and may communicate relevant aspects of this information to engagement teams.

A4038. Information relating to the firm's system of quality management that the firm communicates to the firm's engagement teams may include the following:

- Information related to the firm's culture, for example, the message that each individual has a personal responsibility for quality and is expected to comply with the firm's policies or procedures.
- The firm's responses to quality risks, for example, policies or procedures in relation to the firm's system of quality management that engagement teams are expected to apply at an engagement level ~~(e.g., the firm's policies or procedures in relation to acceptance and continuance of engagements)~~.
- Information that describes the authority, roles and responsibilities of personnel performing functions in relation to the engagement.
- Information related to monitoring and remediation, for example, relevant information about the results of the firm's monitoring and remediation, as contemplated by paragraph 5049 of this standard.
- *[Placeholder - add an additional example on communicating inspection findings on component auditors once networks has been further developed]*

A4139. Information relating to the firm's system of quality management that is relevant to personnel performing functions in relation to the operation of the firm's system of quality management, including those who are ultimately responsible and accountable for quality, may include the following:

- Information that describes the authority, roles and responsibilities of personnel performing functions in relation to the operation of the firm's system of quality management.

- Information that supports the oversight of the firm's system of quality management by those who are ultimately responsible and accountable for quality, for example, changes in the firm and its environment, applicable law, regulation or relevant ethical requirements, and the results of the firm's monitoring and remediation, as contemplated by paragraph [5049](#) of this standard.
- Information relevant to establishing the quality objectives, identifying and assessing the quality risks and designing responses, for example, the types of services the firm provides, the industries it serves and the entities to whom services are provided or, when the firm operates as part of a network, the extent to which the network has addressed the quality objectives, quality risks and related responses [*Placeholder for networks – may need to be revisited once networks has been further considered*].
- Information relevant to the operation of the responses identified, including information obtained from engagement teams, for example, information regarding the financial interests of the firm's personnel that enables the firm to identify and evaluate threats to the firm's independence, information communicated by an engagement team regarding non-audit services provided to an entity or information communicated by engagement quality control reviewers.
- Information related to monitoring and remediation, for example, relevant information about the results of the firm's monitoring and remediation, as contemplated by paragraph [5049](#) of this standard.

[A420](#). Communication with those who are ultimately responsible and accountable for quality provides them with the information needed to exercise their oversight of the firm's system of quality management, including monitoring the effectiveness as well as the appropriateness of remedial actions in response to identified deficiencies, as contemplated by paragraph [498](#) of this standard.

~~[A41](#)~~. [*Moved to para. A45 below*]

[A432](#). [*Placeholder for reference to the requirements in ISA 220 addressing communication with the firm and also to consider examples of communication with personnel outside the firm, e.g., shared service centers. Examples include:*

- *Information on identified threats or breaches of the firm's independence policies or procedures.*
- *Information in respect of the engagement strategy that is relevant to the firm's monitoring activities.*
- *Information in relation to the firm's policies or procedures in respect of new engagements.]*

[A443](#). Establishing policies or procedures to facilitate communication of relevant information supports a proper functioning of the firm's system of quality management. Such policies or procedures may include specifying the nature of the information, the individuals within the firm with whom such information should be communicated and the frequency and manner of the communication. Paragraph [276](#) also requires the firm to establish policies or procedures addressing whistleblowing, which may include establishing processes for the communication of matters on an anonymous or confidential basis.

[A45](#). [*Moved from para. A41 above*] Parties that are external to the firm may include the network, network firms, external oversight authorities, users of the firm's reports, management or those charged with governance of the firm's clients, external service organizations or the firm's legal counsel. Information that is exchanged with parties that are external to the firm may include the following:

- Information about the firm or network's monitoring activities between the firm and the network. *[Placeholder to refer to interaction with networks]*
- Information relating to the design, development and performance of the firm's system of quality management communicated to external oversight authorities.
- Information relating to external inspection findings that is received by the firm from external oversight authorities.
- Information about the firm's internal indicators of audit quality that is communicated to the firm's stakeholders, including those charged with governance of the firm's clients (e.g., through the firm's transparency report).
- Information relating to the firm's compliance with the requirements of professional standards and applicable legal and regulatory requirements, for example, information required by professional bodies with respect to the registration of the firm's engagement partners.
- Communication to external service organizations relating to the firm's policies or procedures.

A464. There are a variety of methods the firm may use to communicate information, for example, manuals of policies or procedures, newsletters, alerts, systems (e.g., the firm's engagement software), emails, intranet or other web-based applications, training, presentations, social media, webcasts or through one-on-one discussions. In determining the most appropriate method(s) and frequency of communication, the firm may take into consideration the nature and urgency of the information being communicated and the audience to whom the information is being communicated. In some circumstances, the firm may determine it necessary to communicate the same information through multiple methods in order to achieve the objective of the communication and in such cases the consistency of the information communicated is important to its effectiveness. In considering the method of the communication, the firm may take into consideration cultural, ethnic and generational differences in order to enable effective communication (e.g., the firm may translate information into different languages).

A475. In accordance with paragraph 4039(b), the firm's monitoring activities include an evaluation of the firm's information and communication and whether it enables and supports the proper functioning of the firm's system of quality management.

#### Considerations in Relation to the Size and Complexity of the Firms ~~Specific to Smaller Firms~~

A486. Communication internally within a smaller firm is likely to be undertaken in a more direct manner as there are fewer personnel with whom to communicate, and those personnel performing functions in relation to the operation of the firm's system of quality management may be the same personnel performing the engagements. Accordingly, in such circumstances, the communication processes and methods may be less structured. Furthermore, the external parties with whom the firm communicates may also be less extensive in a smaller firm. For example, the smaller firm may not belong to a network, may not be subject to oversight by external authorities or may not perform engagements in relation to entities that have a public interest and therefore has a fewer number of users of the firm's reports.

### Quality Management Process (Ref: Para. 320–510)

A497. The firm's process for establishing the quality objectives, identifying and assessing the quality risks, and designing and implementing responses involves the consideration of both internal and external factors. Examples of internal and external factors include:

- Economic, regulatory, jurisdictional, technological and social factors.
- The organization of the firm, including the geographic dispersion, use of audit delivery models, shared service centers or outsourced service providers.
- The firm's resources, including technologically, intellectual and human resources.
- The types of services the firm provides, the industries it serves and the nature of the entities to whom the services are provided.
- The firm's stakeholders, for example, users of the firm's reports, regulatory authorities, preparers and those charged with governance.

### Establish Quality Objectives (Ref: Para. 320–332)

A5048. The firm is required to ~~establishes~~ quality objectives that include the quality objectives set out in paragraph 32, which support the overall objective set out in paragraph 17. The firm is further required to consider whether additional quality objectives should be identified as a result of ~~specific to~~ the firm's circumstances, including the nature of engagements performed by the firm based on the quality objectives set out in paragraph 32 that support the overall objective of this ISQC set out in paragraph 16 (the overall objective of the system of quality management). The firm may also establish additional ~~Such quality objectives may be more granular than the quality objectives set out in paragraph 32, or they may be additional to the prescribed quality objectives, for example, they may relate in relation~~ to other aspects of the firm that are not relevant to the overall objective of the firm's system of quality management, for example, objectives in relation to its financial performance or future growth.

A5149. Circumstances when it may be appropriate for the firm to establish more granular quality objectives include larger or more complex firms when more granular quality objectives may be established according to the nature of engagements performed by the firm (e.g., quality objectives specific to audits of financial statements) or according to the structure of the firm (e.g., quality objectives specific to a particular division of the firm, including the firm's alternative delivery model). In some circumstances, the firm may determine that the quality objectives set out in paragraph 32 are established at an appropriate level of granularity for the firm and that additional quality objectives are not necessary. Quality objectives are established at an appropriate level of granularity that allows for the quality risks to be appropriately identified, assessed and addressed. Larger and more complex firms may establish quality objectives at a firm level, and cascade more granular quality objectives to various levels within the firm. On the other hand, smaller and less complex firms may cascade more granular quality objectives directly to the engagement level, for example, in circumstances where the firm performs a limited number of engagements to which the quality objective relates.

A50. ~~In establishing the quality objectives, the firm also considers the firm's governance principles in relation to quality and whether such objectives support and are consistent with such principles. Furthermore, given that the firm's quality objectives reflect the circumstances of the firm, they are affected by the decisions of the firm that are guided by the firm's governance principles. In some~~

~~circumstances, the firm may establish specific quality objectives that relate directly to the governance principles in relation to quality.~~

~~A51. Quality objectives may be established to apply to the entire firm or may be categorized by engagements performed by the firm or the firm's personnel. For example, the firm's quality objectives related to independence may be established to apply to the entire firm or all firm personnel, whereas the firm's quality objectives related to compliance with professional standards may be categorized to apply to the services performed by the firm or the personnel performing those services.~~

~~A52. In establishing the quality objectives, the firm considers whether the quality objectives are consistent with the firm's governance principles in relation to quality. In some circumstances, the firm may establish specific quality objectives that relate directly to the governance principles in relation to quality.~~

~~A53. In establishing the quality objectives, paragraph 31(b) requires the firm to consider whether the quality objectives are relevant to the circumstances of the firm and whether all relevant quality objectives have been identified. In addition, the firm may also consider the continued appropriateness/relevance of the quality objectives as a result of, for example:~~

- ~~• Changes in the factors and circumstances affecting the firm (e.g., a new service offering, changes in the firm's environment or other factors set out in paragraph A497).~~
- ~~• Other information, such as the results of monitoring activities or information communicated by engagement teams related to the firm's system of quality management.~~

~~Accordingly, the frequency of the firm's consideration of the continued relevance/appropriateness of the quality objectives, including whether all relevant quality objectives have been identified depends on the rate of change in the factors and circumstances affecting the firm, the timing of when other information becomes available to the firm and the urgency of responding to such changes or information in the context of the firm's system of quality management.~~

~~A53. When establishing the quality objectives for the first time, the firm may establish the quality objectives based on the firm's existing system of quality management (i.e., taking into consideration the activities that are already established by the firm and determining the intended purpose of such activities). The firm may also establish additional quality objectives, or may determine that the activities do not relate to quality objectives that are relevant to the overall purpose of the firm's system of quality management.~~

#### *Perform Quality Risk Assessment (Ref: Para. 343–364)*

A54. The identification and assessment of the quality risks forms the basis for the firm's determination of the nature, timing and extent of the firm's response to such quality risks and influences how the firm allocates its resources. ~~In the process of identifying the quality risks, the firm may also identify additional quality objectives that have not already been established. The firm identifies quality risks based on the circumstances of the firm, including the nature of engagements performed by the firm, and that include the quality risks set out in paragraph 36.~~

A55. The firm's process for identifying and assessing the quality risks may involve a combination of ongoing and periodic risk identification and assessment procedures. The firm identifies the quality risks that, individually or in combination, could reasonably have an adverse impact on the firm's ability

to achieve the overall objective, i.e., the firm is not required to identify risks to quality that the firm believes may have a limited effect on the firm's ability to achieve its overall objective.

A56. The nature of the quality risks that are identified and the assessment of their likelihood and impact varies based on the firm and its circumstances, and includes the internal and external factors set out in paragraph A497. For example:

- Firms that perform more complex engagements may have a heightened need for technical resources to support consultation and accordingly the risk that such resources are not available may be more significant for such firms.
- The impact of the loss of an engagement partner on a smaller firm may be more significant than for a larger firm and accordingly the quality risk in relation to the loss of engagement partners may be assessed to have a greater impact for such firms.

A57. Similar to the considerations in relation to quality objectives, the firm may consider the continued relevance appropriateness of the quality risks, including whether all relevant quality risks have been identified as a result of, for example:

- New or changes to the conditions, events, circumstances, actions or inactions that could affect the firm's ability to achieve its quality objectives.
- Other information, such as the results of monitoring activities, including external inspections, or information communicated by engagement teams related to the firm's system of quality management.

Accordingly, the frequency of the firm's quality risk identification and assessment depends on the rate of change of the above factors, the timing of when other information becomes available to the firm and the urgency of responding to such changes or information in the context of the firm's system of quality management.

~~A58. When identifying the quality risks for the first time, the firm may identify the quality risks based on the firm's existing system of quality management, i.e., taking into consideration the activities that are already established by the firm and determining the quality risks that such activities are intended to address.~~

A589. In assessing the likelihood and impact of the quality risks, the firm may take the following factors into consideration:

- The likelihood of whether or not the quality risk could occur and the expected frequency of its occurrence.
- The rate at which the impact would take place, or the amount of time that the firm has to respond to the quality risk. For example, when changes in professional standards are effected, there is typically a period of time allowed for implementation. On the other hand, the effect of high turnover of firm personnel may be more immediate and the firm may not have been able to prepare for such an event.
- The duration of time of the impact after the quality risk has occurred. For example, a change in a professional standard may have a more long-term impact when it becomes effective, since the firm may need to train its personnel on the changes or update methodology, although the effect of such change may lessen over time. Conversely, a breach of the firm's independence policies or procedures may have a more short-term or immediate effect.

A59. [Placeholder for application material in relation to the prescribed quality risks, including consideration of the application material in paragraphs A7–A40 and A52–A63 of extant ISQC 1]

#### *Design and Implement Responses to Quality Risks (Ref: Para. ~~376~~–~~387~~)*

- A60. A response to a quality risk comprises the firm's actions to address a quality risk. Such actions may include, among others, establishing policies or procedures, assigning responsibility, communicating, providing training, performing reviews or establishing resources. ~~In some circumstances, the firm may determine that the quality risk is so significant that it is best avoided, for example, the firm may determine that a particular service will not be offered, or the firm will not provide services to a particular industry or type of entity. The response to a quality risk may be implemented at an engagement level. ISA 220, ISRE 2400 (Revised) and ISAE 3000 (Revised) establish requirements for the engagement partner in relation to the management of quality at the engagement level and implementing firm level requirements at an engagement level, for example, the firm's policies or procedures.~~
- A61. ~~Paragraph 22 requires the firm to implement governance principles in relation to quality.~~ In addition to addressing the quality risks, the firm's responses may also address the firm's governance principles, i.e., they may represent the actions required by ~~Paragraph 232~~ requires for the firm to implement governance principles in relation to quality. For example, the firm's responses in relation to compliance with relevant ethical requirements may assist the firm in embedding the firm's internal culture, in particular the professional and ethical values.

#### *Policies or Procedures*

- A62. Policies or procedures reflect the internal culture of the firm and clearly establish what is expected, and who is responsible and accountable. Structured documentation of the firm's policies or procedures may not be necessary in all circumstances, for example, the policies or procedures could be stated in communications or implied through the actions and decisions of firm leadership. The extent to which the firm establishes policies or procedures, and the manner in which those are documented and communicated, depends on the circumstances of the firm. Nevertheless, a lack of awareness of the firm's policies or procedures and the circumvention of policies or procedures is more possible when they are not documented. In a more complex firm, establishing robust policies or procedures that are well documented may be more important in order to achieve consistency across the firm.
- A63. ~~Throughout this ISQC, the firm is required to establish policies or procedures in relation to specific areas of the system of quality management, for example, the prescribed responses in paragraph 37 require the firm to establish policies or procedures in order to address the quality risks set out in this standard. However, ~~t~~ While the responses designed and implemented by the firm to address quality risks that are additional to the prescribed responses in paragraph 37 may comprise forms of responses other than policies or procedures, for example, those explained in paragraph A60, certain requirements throughout this ISQC and ISQC 2 require the firm to establish policies or procedures in relation to specific areas of the system of quality management.~~

#### *Nature, Timing and Extent of the Firm's Response*

- A64. The assessment of the quality risk affects the firm's responses, for example, certain quality risks may not require any action to reduce the likelihood or impact further or the firm may choose to avoid the

risk, for example, by not providing a particular service to which the quality risks relates. In other circumstances, due to the assessment of the quality risks, additional or more rigorous responses may be required.

- A65. The nature, timing and extent of the firm's responses to the identified quality risk depends on the conditions, events, circumstances, actions or inactions that give rise to the quality risk. For example, if the firm's quality risk relates specifically to a particular industry or category of clients (e.g., audits of financial statements of listed entities), the firm's responses may only require specific actions in relation to clients in the industry or that are within the category, rather than all engagements performed by the firm.
- A66. The nature, timing and extent of the firm's responses may also vary based on factors such as the size and complexity of the firm. For example, in a smaller firm, due the concentration of the firm's operations, the closer oversight by the firm's leadership may be an effective and appropriate response to certain risks. In addition, in some circumstances, the response may be most effectively established at an engagement level, for example, a smaller firm may perform only a few engagements of a specific type and it may be more effective for the quality risk to be addressed directly at the engagement level rather than establishing formal policies or procedures at the firm level that are cascaded down to an engagement level.
- A67. In designing a response to a quality risk, the firm may take many factors into consideration, including:
- Whether the response should involve a preventative activity that would avoid the conditions, events, circumstances, actions or inactions, or whether an activity that is more detective in nature would be appropriate. For example, developing the competence and capabilities of engagement team members through training, supervision and review assists in the prevention of conditions, events, circumstances, actions or inactions, whereas a pre-issuance review at the end of the engagement is more detective in nature.
  - Whether the response should be a manual process or whether the quality risk would be more appropriately addressed through automated means, for example, the firm may be able to use data analytic techniques or other technologies.
  - The appropriate timing of the response activities, for example, certain activities may need to operate on a continuous basis in order to be effective (e.g., monitoring and reporting breaches of the firm's independence policies or procedures).
  - Whether the response alone is sufficient to address the quality risk, i.e., a combination of responses may be necessary to appropriately address the quality risk.
  - Whether there are responses that address multiple quality risks and therefore may be more effective to design and implement.
  - The appropriate resources to support the response. For example, certain responses may need to be performed by competent personnel with the appropriate knowledge, time and experience, or the firm may need to source technological or intellectual resources to support the functioning of the response (e.g., application systems and hardware or a firm methodology for the performance of engagements).
  - The information to be obtained, generated and communicated in relation to the response.

- A68. In addition to these factors, as part of designing ~~the firm's~~ response, the firm may address how deviations should be addressed. For example, in relation to a pre-issuance review, the firm may indicate how engagement deficiencies should be addressed, or in relation to training firm personnel, the firm may specify the repercussions on firm personnel who do not attend the training.
- A69. Certain responses may be designed as in-process monitoring activities and are unrelated to the firm's monitoring and remediation process. For example, the firm may implement activities to monitor breaches of the firm's independence policies or procedures and as part of the firm's monitoring and remediation process, the firm may monitor the in-process independence monitoring activities to determine whether they effectively address the quality risks related to independence.
- A70. Similar to the considerations in relation to the quality objectives and quality risks, the firm may consider the continued appropriateness of the responses, including whether other responses may be more effective. For example, new software may be introduced that allows the firm to more effectively address a particular risk, or the firm may reallocate responsibilities. Furthermore, the results of monitoring activities, including external inspections, or information communicated by engagement teams related to the firm's system of quality management may also indicate the need for the responses to be considered. Accordingly, the frequency of the firm's consideration of the continued appropriateness of the responses and whether other responses may be more effective depends on changes in the firm's quality objectives and quality risks, as well as when information becomes available to the firm and the urgency of responding to such information.

### *Monitoring and Remediation*

#### Establishing a Monitoring and Remediation Process (Ref: Para. 398)

- A71. In addition to supporting the firm's evaluation of whether the system of quality management provides the firm with reasonable assurance that its overall objective has been achieved, monitoring and remediation facilitates the improvement of engagement quality and the firm's system of quality management.
- A72. A monitoring and remediation process typically involves the following steps:
- Design monitoring activities, including the nature, scope and frequency of such activities;
  - Perform internal monitoring activities;
  - Assess the results of the monitoring activities and external inspections, in order to identify deficiencies in the firm's system of quality management;
  - Address deficiencies identified if there is an indication that a report may be inappropriate or that procedures were omitted during the performance of an engagement
  - ~~Determine-Investigate~~ the root cause(s) of deficiencies and evaluate the effect of deficiencies;
  - Implement appropriate remedial action(s);
  - Monitor the effectiveness of the remedial actions and evaluate whether the remedial actions appropriately address deficiencies; and
  - Communicate matters in relation to monitoring and remediation.

Monitoring the Firm's System of Quality Management (Ref: Para. ~~4039~~–410)

A73. Monitoring of the implementation of the governance principles in relation to quality includes evaluating the actions of leadership with respect to the organization, culture and strategy of the firm.

A74. In determining the scope and frequency of the monitoring activities, in addition to the matters set out in paragraph 4~~10~~, the firm may consider other factors such as:

- The size of the firm, the types of services the firm provides, the industries it serves and the nature of the entities to whom services are provided.
- The structure and organization of the firm, including the involvement of the network firm in monitoring activities.
- The firm's infrastructure, for example, technology and resources to support monitoring activities.
- The firm's assessment of the quality risks identified (e.g., the firm may determine that ongoing monitoring activities are necessary in relation to responses that address higher quality risks).

A75. The frequency of the firm's monitoring activities may comprise ongoing monitoring activities ~~that are embedded within the firm's quality management process~~, periodic monitoring activities or a combination of both. Ongoing monitoring activities are generally ~~described as~~ routine activities, built into the firm's processes and performed on a real-time basis, reacting to changing conditions, for example, computerized continuous monitoring techniques over engagement file retention procedures. Periodic monitoring activities are conducted at certain intervals by the firm, for example, inspection of engagements. Since periodic monitoring activities are performed at certain intervals, ongoing monitoring activities may be more effective in identifying deficiencies in the system of quality management in a timely manner. Nevertheless, periodic monitoring activities may be useful in confirming the results of ongoing monitoring activities.

A76. The nature, scope and frequency of the firm's monitoring activities need to be sufficient for the firm to establish whether its system of quality management is effective, and remains effective, in providing it with reasonable assurance that its overall objective has been achieved, or whether changes in the firm's system of quality management should be made. For example:

- The firm's monitoring activities in relation to evaluating whether the business strategy reflects the professional and ethical values of the firm and recognizes the need for the firm to achieve quality in all engagements of the firm may be performed periodically. If there have been no changes in the firm's business strategy, the firm's monitoring activities may not need to be performed frequently.
- The firm may determine that more frequent monitoring activities are needed in relation to certain types of engagements, for example, entities operating in industries that are subject to frequent change or engagements where a high number of deficiencies have been identified through previous monitoring activities. Such monitoring activities may be ongoing, for example, a pre-issuance review, or may be performed periodically such as an annual inspection of an engagement.
- Due to the increased risk of deficiencies, the firm's monitoring activities in relation to matters related to independence may comprise ongoing activities in order that breaches of independence are identified in a timely manner, and may include automated systems to

capture and monitor information. The firm may also perform periodic monitoring activities, such as inspecting personnel's financial affairs for compliance with the firm's independence policies or procedures.

A77. Examples of monitoring activities may include:

- Evaluating actions by leadership in establishing an appropriate tone at the top and culture that supports quality.
- Interviewing firm personnel to evaluate the effectiveness of the firm's communication in relation to certain matters.
- Evaluating who within the firm has been assigned responsibility for establishing the quality objectives, identifying and assessing quality risks and designing responses to the quality risks, and how such personnel have gone about doing so.
- Peer reviews, or other types of reviews, designed with the purpose of monitoring areas of the firm's system of quality management.
- Automated alerts in relation to engagements, for example, automatic notifications when policies are not applied.
- Inspecting records regarding the provision of non-audit services by other service lines within the firm to establish that prohibited services were not provided to an audit client.
- Checking records of attendance at training events for compliance with the firm's policies on professional development.
- Inspecting time records for (i) number of hours spent by engagement partners and other senior personnel and assessing the appropriateness of such hours; or (ii) evidence of involvement of experts on certain types of engagements such as audits performed in respect of certain industries, to determine the appropriate use of experts.
- *[Placeholder for additional examples that are SMP specific – feedback being sought through SMPC]*

A78. The purpose of monitoring activities is to evaluate the design, implementation and operation of the firm's system of quality management, including the responses designed and implemented by the firm in response to quality risks. In some circumstances, the firm may implement procedures in response to quality risks that, by their nature, may appear to fulfill the purpose of monitoring activities. For example, the firm may implement procedures to monitor breaches of the firm's independence policies or procedures as a response to a particular quality risk in relation to the firm's compliance with relevant ethical requirements. Although such procedures may be described as monitoring activities, they form part of the firm's responses to quality risks, and as such are subject to the firm's monitoring process.

A79. While paragraph 42 requires the firm to perform inspections of completed engagements on a periodic basis, engagement reviews that are undertaken during the course of the engagement may be more effective to prevent a deficiency as such reviews provide an opportunity for the deficiency to be rectified before the engagement report is issued. Reviews that are undertaken during the course of the engagement may be considered monitoring activities when they are designed to evaluate the design, implementation and operation of the firm's system of quality management.

**A8079.** The firm's system of quality management may change as a result of various factors, for example:

- Changes in factors that affect the quality objectives and quality risks (e.g., a new service offered by the firm or changes in the firm's environment).
- Changes to address an identified deficiency in the firm's system of quality management.
- Other factors, such as the firm amends the responses to quality risks because these become obsolete over time or more effective responses are designed and implemented

When changes occur, previous monitoring activities undertaken by the firm may no longer provide the firm with information to support the evaluation of its system of quality management and therefore the firm's monitoring activities may include monitoring areas of change. Furthermore, previous monitoring activities undertaken by the firm may also no longer provide the firm with information to support the evaluation of its system of quality management in relation to areas that have remained the same, for example, because of the time period since the monitoring activities were undertaken. Accordingly, the firm considers the continuing relevance of previous monitoring activities, which includes understanding changes in factors that impact the firm's system of quality management, as well as when such monitoring activities were performed.

**A810.** The outcome of the firm's previous monitoring activities may also indicate areas where monitoring activities should be undertaken, for example, monitoring may need to be undertaken in certain areas where there is a history of deficiencies. The firm may also obtain other information that may suggest deficiencies in the firm's system of quality management and therefore may indicate the need for the firm to conduct monitoring activities, for example, the firm may conduct monitoring activities in response to the results of external inspection findings in order to further understand such findings and their effect on the firm.

Engagement inspections (Ref: Para. **424**)

**A824.** Paragraph **424** requires an inspection of at least one completed engagement for each engagement partner, on a cyclical basis determined by the firm, which is ordinarily three years. In addition, the firm establishes criteria to determine other engagements for inspection that, together with the engagements subject to cyclical inspection, provide a sufficient basis to enable the firm to evaluate its system of quality management. Such criteria may include:

- Engagements where the firm or engagement partner are inexperienced, for example, a new industry, service offering or new engagement partner.
- The inspection of particular engagements on a more regular basis, for example, engagements performed in respect of certain entities (e.g., a listed entity).
- Engagements subject to external inspection that have negative findings, or engagements where the results of previous internal inspections identified deficiencies.
- Engagements where there has been a material restatement of comparative information in the financial statements or the firm's report required reissuance.

**A832.** The nature, timing and extent of the inspection cycle and the frequency of selection of individual engagement partners or individual engagements, depends on many factors, such as the following:

- The size of the firm, including the number and geographic location of offices.

- The nature and complexity of the firm's practice and organization.
- Who performs the inspection, for example, whether it is the individual office, the firm or the network firm.
- The extent of other monitoring procedures implemented by the firm, for example, peer reviews undertaken in conjunction with other firms or certain types of pre-issuance reviews that qualify as monitoring activities.

A843. Evaluating completed engagements involves performing procedures designed to provide evidence of compliance by engagement teams with the aspects of the firm's system of quality management relevant to the engagement. In determining the nature and extent of the procedures to be undertaken in performing the evaluation of completed engagements, the firm may take into consideration a variety of factors, for example, the assessment of quality risks or areas of change in the firm's system of quality management (e.g., circumstances when the firm has introduced a new policy or procedure). Such procedures may also include performing substantive reviews of the quality of work performed, in particular significant judgments made by the engagement team and the related conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report.

Objectivity of those performing monitoring activities (Ref: Para. 432)

A854. The determination of whether those performing monitoring activities are sufficiently objective depends on the activity subject to monitoring. For example, an activity involving the exercise of judgment may necessitate heightened objectivity by those performing the monitoring activities than activities with no judgment (e.g., the monitoring of the firm's policies or procedures addressing differences of opinion). In some circumstances, the monitoring activities in relation to an activity that is automated could be undertaken by those involved with the activity (e.g., the monitoring of the firm's automated process for identifying breaches of the firm's independence policies or procedures). In considering the objectivity of those performing the monitoring activities, the firm may take into consideration the relevant ethical requirements that may explain factors or circumstances that create a threat to objectivity.

A865. Factors or circumstances that may create a threat to objectivity in the case of a monitoring activity involving the inspection of an engagement may include the following:

- A self-review or familiarity threat may arise when the person performing the engagement inspection is a member of the engagement team, the engagement quality control reviewer or was consulted on matters related to the engagement.
- A familiarity threat may arise when the person performing the engagement inspection is a close or immediate family member of the engagement partner, engagement quality control reviewer or another key member of the engagement team.
- An intimidation threat may arise in circumstances when the engagement partner is an aggressive or dominating individual, or the person performing the inspection is in the chain of command of the engagement partner.

## Identifying and Remediating Identified Deficiencies

Evaluating the results of the monitoring activities (Ref: Para. ~~443~~)

A876. Deficiencies in the firm's system of quality management include matters that have the potential to adversely affect the firm's ability to achieve its overall objective. The firm may also identify opportunities to improve the firm's system of quality management as a result of the evaluation of the results of the monitoring activities and external inspections.

A887. The timing of when the firm evaluates the results of the monitoring activities and external inspections may vary. For example, the firm may obtain and evaluate results from ongoing monitoring activities and external inspections on a real-time basis and evaluate such results in real time, thereby enabling the firm to identify the deficiencies and implement remedial actions on a timely basis. However, in other circumstances the firm may evaluate the results of the monitoring activities and external inspections periodically.

A898. A deficiency in the firm's system of quality management may also be identified from sources other than monitoring activities, for example, information from the firm's activities in response to quality risks (e.g., the activities explained in paragraph A78) or information from its whistleblowing program.

A90. The combination of deficiencies identified by the firm may indicate a more severe deficiency in the firm's system of quality management. For example, deficiencies may be identified across many engagement inspections that, individually, may not be considered significant. However in aggregation, these deficiencies may indicate a more significant deficiency in the firm's system of quality management since they appear to be recurring and pervasive.

Determining-Investigating the root cause of deficiencies (Ref: Para. ~~465-476~~)

A9189. The objective of determining-investigating the root cause(s) of deficiencies is to understand the underlying circumstances that caused the deficiencies. An improved understanding of the underlying cause(s) of deficiencies:

- Facilitates the implementation of more effective actions to address deficiencies, thereby improving quality.
- Directly contributes to the improvement of quality at the engagement level through the participation of engagement teams in the root cause analysis process.
- Enables those assigned ultimate responsibility and accountability for quality to have an improved awareness, to enable them to proactively monitor actions taken to address deficiencies.
- Facilitates more effective communication to firm personnel by explaining the actual root cause(s) of deficiencies, rather than the deficiencies themselves.

A920. The nature, timing and extent of the procedures undertaken by the firm to determine-investigate the root cause(s) of deficiencies are affected by the nature of the deficiencies identified, and may include the following factors:

- In circumstances when a deficiency relates to an engagement, whether it appears unique to the individual engagement or appears more systemic and repetitive across many engagements.

- In circumstances when a deficiency relates to a firm-level activity, whether it appears to be an isolated incident, or appears more systemic in that there have been several occurrences.
- The severity of a deficiency in terms of the impact on the engagement or the firm as a whole.
- The extent to which the root cause(s) of a deficiency is apparent and the extent of actions to remediate the deficiency, i.e., the nature and extent of the root cause analysis may be simpler in circumstances when the root cause(s) are more apparent and the related remedial actions are uncomplicated.

A934. While paragraph 465 requires the firm to ~~determine-investigate~~ the root cause(s) of deficiencies, the firm may also undertake a root cause analysis in circumstances where there are engagements where no deficiencies were identified, in order to understand how such engagements achieved the desired level of quality.

A942. Performing a root cause analysis requires those performing the assessment to apply judgment based on the evidence available. The firm's process for ~~identifying-investigating~~ the root cause(s) of deficiencies may include:

- Identifying those responsible for performing the root cause analysis, and establishing their competency to do so, including providing training on how to effectively ~~investigated~~ identify the root cause(s).
- Determining the nature, timing and extent of the root cause analysis.
- Conducting interviews of engagement teams and others, in order to gain insight into what may have caused the deficiency.
- Evaluating the evidence and other information available and identifying the root cause(s) based on such evidence.

A953. The underlying root cause(s) of deficiencies may relate to a variety of factors and there may be many root causes that relate to a particular deficiency. For example, deficiencies may arise as a result of:

- Matters related to firm leadership, for example, the culture of the firm, its organization and structure.
- The firm's information and communication, for example, the firm fails to establish policies or procedures that facilitate the communication of information relevant to the firm's system of quality management with the relevant parties.
- Quality objectives, risks to the quality objectives or responses to address the risks, for example, a risk to a quality objective is not identified by the firm or the firm's response to address a particular risk is inappropriate.
- Resources to support the firm's quality management or engagement teams, for example, an outdated methodology, or absence of technical support.
- Appraisal and reward systems, for example, incentives established for firm personnel that promote financial considerations to the detriment of quality.
- Consultation on difficult issues, or differences of opinion, for example, the firm culture does not promote consultation on difficult issues or the firm's process for addressing differences of opinion is not clear or well established.

- The acceptance and continuance of clients, for example, the firm accepts a client ~~that~~who lacks integrity or the firm accepts an engagement but does not have the capability to perform the engagement.
- The knowledge, skills and experience of firm personnel, for example, engagement team members have insufficient knowledge of the firm's methodology due to a lack of training or the firm does not provide engagement teams with access to experts.
- The behavior of firm personnel, i.e., the values, ethics and attitudes of firm personnel, for example, firm personnel knowingly breach the firm's policies or procedures or disregard professional standards.
- The time and resources allocated to perform the engagement, including when the work is performed.
- Engagement performance issues, for example, engagement team members do not effectively interact with others involved in the audit, e.g., in the case of a group audit.
- Interactions with management and those charged with governance, for example, there is an absence of cooperation and open dialogue with management and those charged with governance, or the engagement team fails to discuss their needs with management and agree an appropriate timetable.
- Contextual factors, including broader cultural factors and talent retention, for example, the firm operates in a jurisdiction where cultural expectations prevent less experienced engagement team members from challenging individuals with more authority (e.g., the engagement partner or client management).

A964. Identifying a root cause(s) that is sufficiently specific supports the firm's process for appropriately remediating deficiencies and achieving the overall objective of the system of quality management. For example, it may be identified that an engagement team lacked the appropriate application of professional skepticism, however the underlying root cause may relate to the cultural environment whereby engagement team members typically do not challenge individuals with more authority.

Evaluating the effect of deficiencies (Ref: Para. 476)

A975. When deficiencies are identified, there is an indication that aspects of the firm's system of quality management are not designed effectively or are not functioning as intended. Accordingly, in evaluating the effect of the deficiencies, the firm considers the continued ~~appropriateness~~relevance of the firm's quality objectives and quality risks, whether all quality risks have been identified and appropriately assessed, and whether the responses to quality risks remain appropriate. Paragraphs A532, A57 and A70 indicate that the frequency of the firm's consideration of the continued ~~relevance~~appropriateness of the quality objectives, ~~or whether all relevant quality objectives have been identified and the appropriateness of the~~ quality risks and responses depends on the rate of changes in the factors and circumstances affecting the firm, the timing of when other information becomes available to the firm and the urgency of responding to such changes or information in the context of the firm's system of quality management.

Implementing appropriate remedial actions (Ref: Para. 487)

A986. The remedial actions are responsive to the root cause(s) identified, for example, if the root cause relates to the firm having insufficient time and resources to perform the engagement, the remedial actions may include implementing additional resources or withdrawing from engagements. The nature, timing and extent of remedial actions may depend on a variety of other factors, including:

- The extent of the impact of the root cause(s), for example, whether it relates to a certain category of engagements, or is more pervasive throughout the firm. In some circumstances, the firm may determine through the root cause analysis that a deficiency is not significant, or is an isolated incident, and accordingly no remedial actions are necessary or urgent.
- The severity of the root cause(s) in the context of the firm's overall quality objectives and therefore the urgency in which it needs to be addressed.
- The effectiveness of the remedial actions in addressing the root cause(s), for example, the firm may need to implement more than one remedial action in order to effectively address the root cause(s), or may need to implement remedial actions as interim measures until such time as the firm is able to implement the most effective remedial actions.

Assessing the Effectiveness of the Monitoring and Remediation Process (Ref: Para. 498)

A997. Monitoring the effectiveness of the remedial actions might result in the need for new or improved remedial actions to address the root cause(s), thereby continually improving the effectiveness of the firm's quality management.

Communicating Matters Related to Monitoring and Remediation (Ref: Para. 5049)

A100. The timing of the communication may need to be more frequent than on an annual basis. For example, the firm may identify deficiencies that are severe or pervasive and therefore it may be appropriate to communicate such deficiencies promptly.

A10198. In determining the information to be communicated in relation to the firm's monitoring activities, including the nature and extent of such communication, the firm may take into consideration the type of which information that is relevant to the particular audience, including the information needs of the audience as a result of their defined roles and responsibilities. For example:

- Information communicated to engagement teams may be focused on deficiencies that have been identified at an engagement level and therefore are likely to be relevant to this audience.
- Information communicated to all firm personnel may relate to matters relevant to compliance with the firm's independence policies or procedures as such policies or procedures may apply to all firm personnel.

Communicating the root cause(s) of deficiencies increases awareness and understanding of why deficiencies occurred, which may influence the behaviors of engagement teams and firm personnel. Furthermore, communicating remedial actions on a timely basis may support the implementation of such actions.

A10299. The communication of deficiencies to individuals other than the relevant engagement partners need not include an identification of the specific engagements concerned, although there may be

cases where such identification may be necessary for the proper discharge of the responsibilities of the individuals other than the engagement partners.