

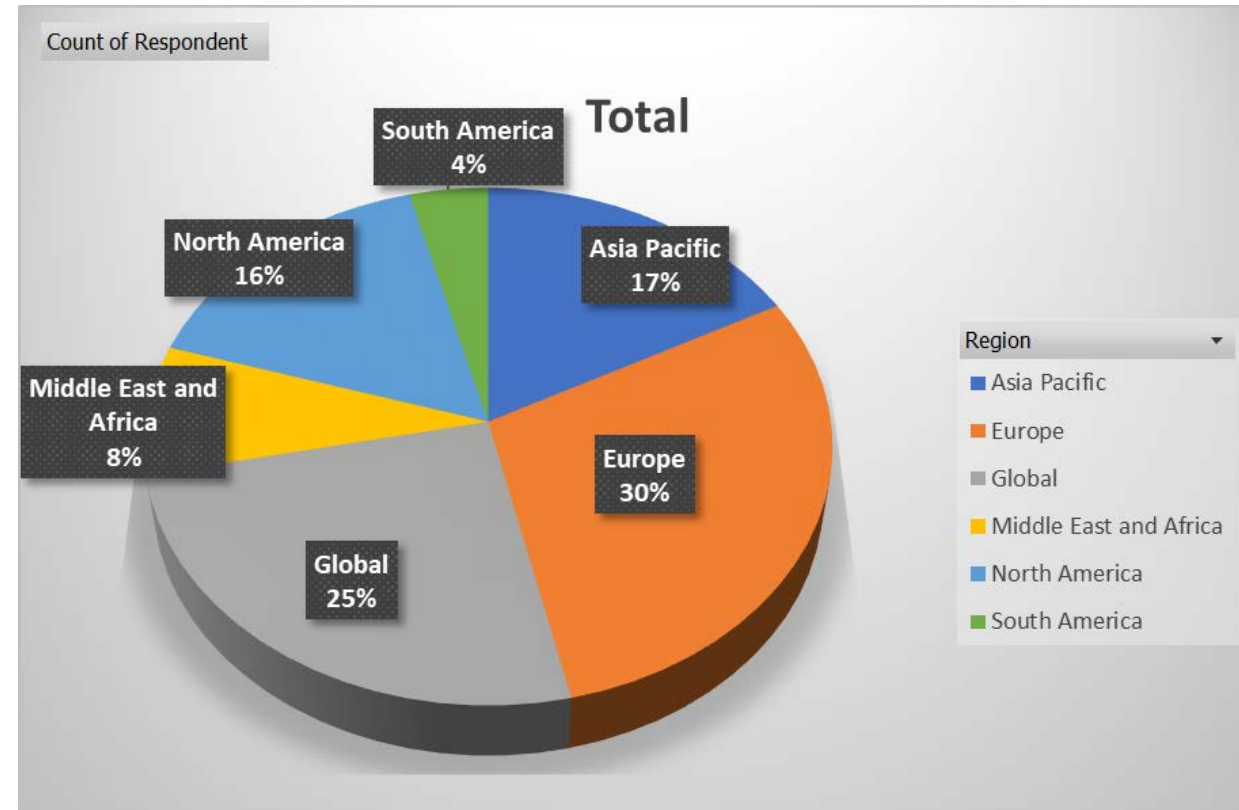
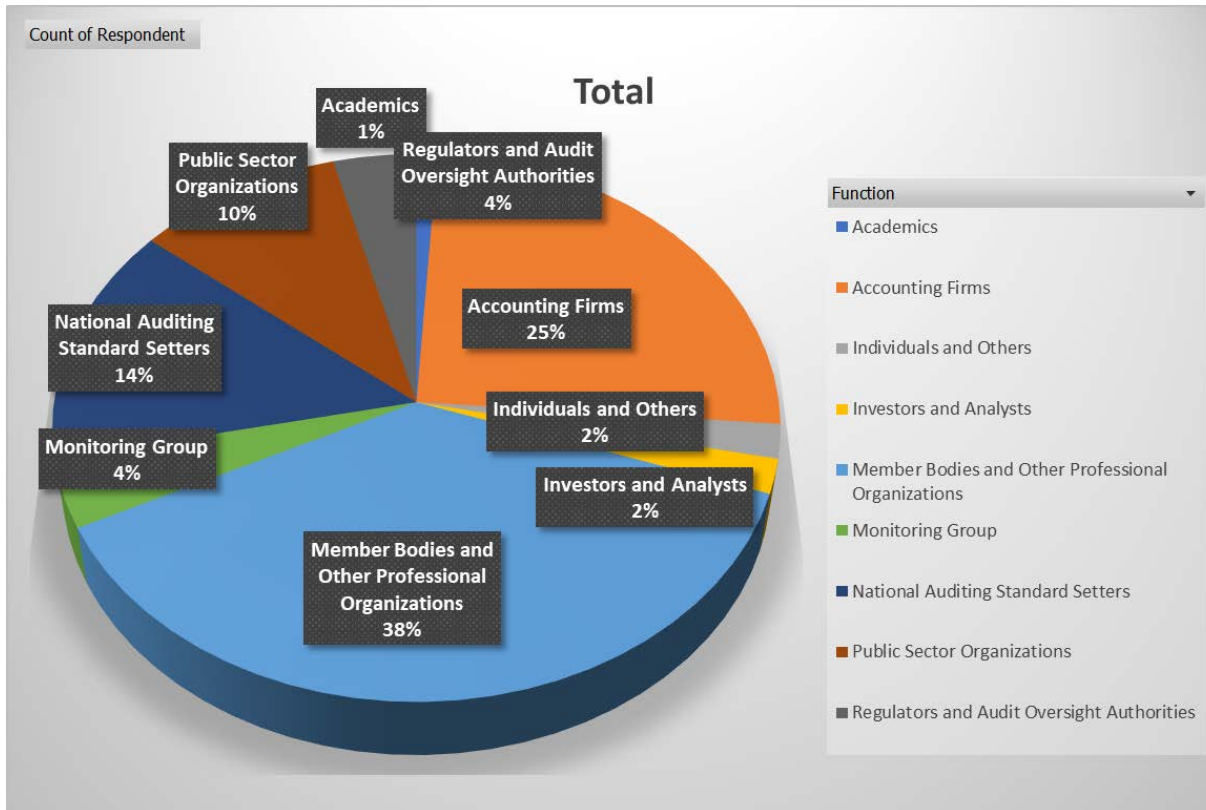
A wide-angle photograph of the New York City skyline, featuring numerous skyscrapers and buildings along the waterfront. The image is used as a background for the presentation slide.

# ISQM 1: Overview of Feedback from the Exposure Draft and Outline of Proposals to Address Certain Issues

**Presented by:**  
**Karin French, ISQM 1 Task Force Chair**

**IAASB CAG Meeting September 2019**

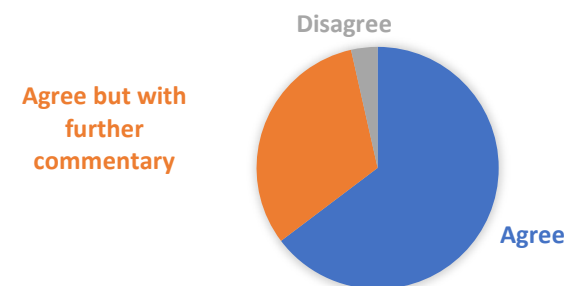
# Overview of Respondents



# New Quality Management Approach (QMA)

- MG:
  - Enhancements needed to improve proactive and preventative approach
  - Needs to be able to support enforcement
- Other respondents:
  - Positive:
    - Promotes tailored systems and a proactive, integrated and thinking approach to quality management (QM)
    - Will help firms meet challenges facing the profession
  - Concerns:
    - How ED-ISQM 1 incorporates a QMA - hybrid of a risk-based approach and prescriptive requirements
    - Length and complexity of the standard
  - Suggestions included:
    - Reducing prescriptiveness of quality objectives and responses and more explicitly addressing quality risks
    - Restructuring the standard
    - Emphasis on aligning QM with the firm's business strategy and incorporating QM into enterprise risk management

## Q1(a) New Quality Management Approach

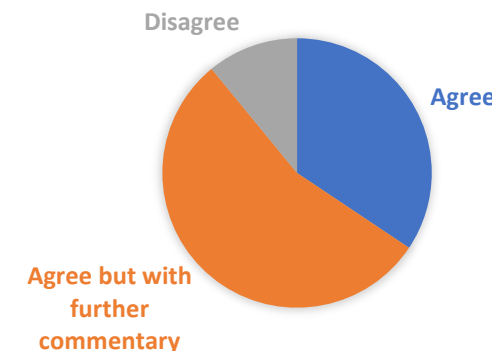




## Benefits for Engagement Quality and Professional Skepticism (PS)

- MG:
  - Support how ED-ISQM 1 addresses PS
  - Also address PS in governance and leadership
- Other respondents:
  - SOQM is the foundation for consistently delivering high quality engagements
  - Governance and leadership is critical to embedding and supporting a culture of quality and a focus on professional skepticism
  - Effect of the standard and expected benefits would vary from firm to firm
  - Address PS in other areas of the standard, particularly governance and leadership
  - Concerns:
    - Benefits may be limited for SMPs
    - Prescriptiveness = checklist mindset = unlikely to improve engagement quality
    - Implementing standard will be resource intensive – possible negative effect on engagement quality
    - Cost-benefit analysis needed
    - Extent of documentation needed to demonstrate compliance with the standard

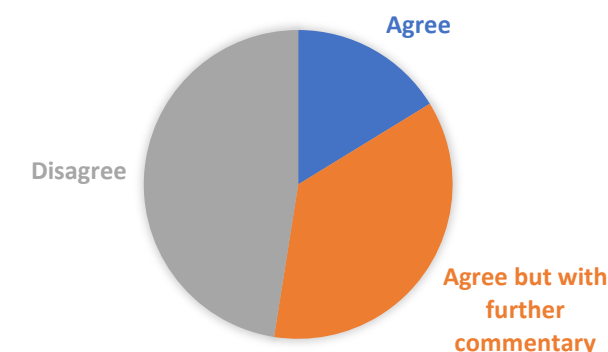
### Q1(b) Benefits for Engagement Quality and Professional Skepticism



# Scalability

- MG:
  - Need for larger firms to scale-up (i.e., additional to what is in the standard)
  - Length of standard and proposed additional guidance – need for a critical review and improved clarity of standard
- Other respondents:
  - Examples and guidance will be needed to demonstrate scalability – however, the need for examples and guidance indicates lack of clarity of standard
  - Concerns:
    - Prescriptiveness of the standard - not scalable, and having required responses with no quality risks indicates approach is not risk-based
    - Length and complexity
    - Threshold for identifying quality risks is too low
    - Documentation burden (“comply or explain”)
    - Standard appears written for large firms – bottom-up approach needed
    - Firms that perform non-audit services – increasing trends to perform other engagements instead of audits, wide variance in degree of public interest, ITC addressed audit issues, ED-ISQM 1 very audit focused, ED-ISQM 1 not suitable for firms performing related services engagements

Q1(c) Scalability



## Scalability (continued)

- Suggestions:
  - Separate requirements or standards for managing quality for non-audit engagements or audits of less complex entities
  - Simplify requirements and reduce repetitiveness
  - Use certain explanations and diagrams from the Explanatory Memorandum
  - More clearly signpost paragraphs that address scalability
  - Use the same approach that is being considered in the project on ISA 315 (Revised) (i.e., the what/how/why approach)
  - Place material outside of the standard
  - Digitize the standard

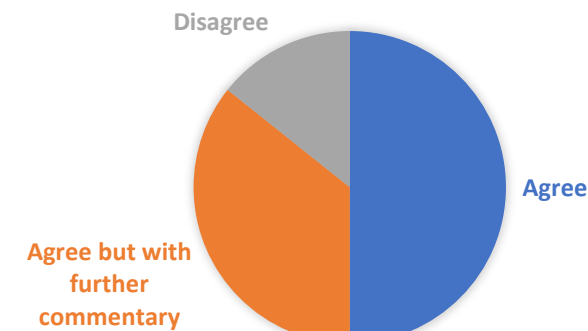
## Challenges for Implementation

- Time, resources and expertise to implement the standard
- Firm-wide impact:
  - Need for a firm-wide mindset change, and influences the culture of the firm
  - Organizational restructuring, new IT systems
  - Affects other areas of the firm, e.g., human resources and IT functions
- Professional judgment – differing interpretations and concerns about level of documentation needed
- Firm's risk assessment process (FRAP) – identified as particularly challenging to implement
- Other areas of challenge:
  - Monitoring and remediation (M&R) - root cause analysis, identifying and evaluating findings and deficiencies and firm leadership's annual evaluation of the system of quality management
  - Consistent application for networks – includes challenges around consistency of global standards
  - Documentation – some consider standard too burdensome, others suggesting more clarity needed about what needs to be documented
- Length and complexity of standard – difficult to read and understand
- Strong call for support materials and guidance, including clarity regarding what has changed from extant ISQC 1

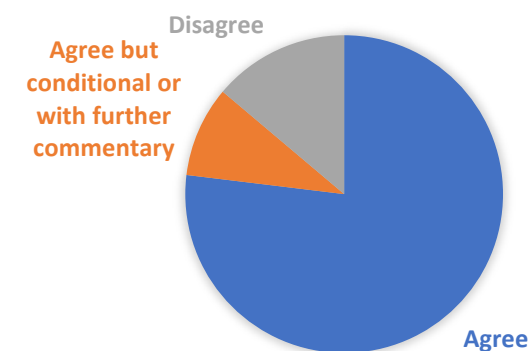
# Components and Structure

- Standard has a logical organization and support flexibility of the components
- Concerns and suggestions
  - FRAP should be the first component – helps provide context to standard, even though governance and leadership is very important
    - Also clarifies that FRAP applies to the other components
  - FRAP and M&R are processes in nature and should not be described as components or treated in the same way as other components – “what” is managed vs. “how” it is managed
  - FRAP should not apply to M&R
    - Requirements in M&R already prescriptive – establishing quality objectives and identifying and assessing risks causes circularity
  - Information and communication are necessary for other components to function – should be integrated into the other components

Q4 Components and Structure



Q6(a) FRAP Applies to Other Components

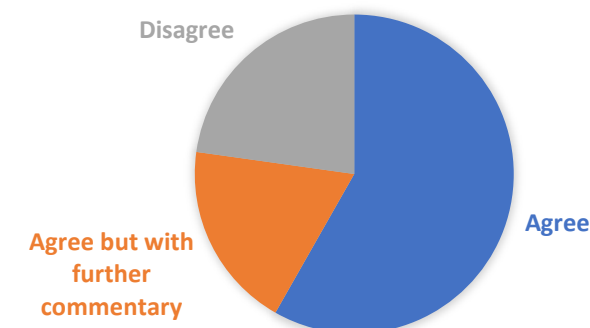




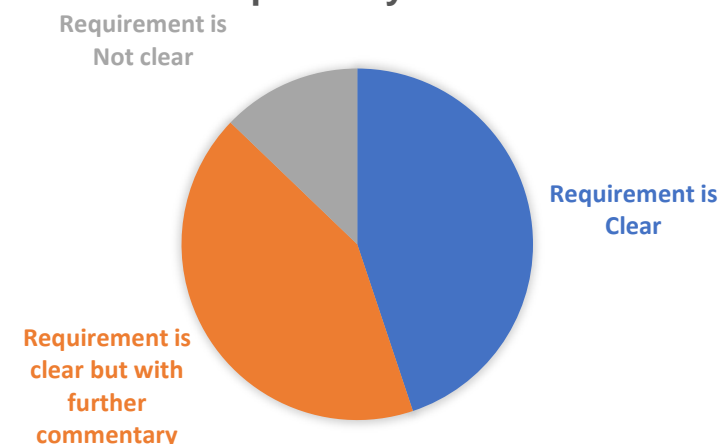
## Establish Quality Objectives (QO)

- MG:
  - Clarity needed on when and how additional QO should be developed
  - Suggested requirements that support establishing more granular quality objectives to support identifying and assessing quality risks (QR)
- Other respondents:
  - Mixed views
    - QOs are comprehensive, outcome-based and give a steer to firms about the starting point
    - QOs are too prescriptive – should be more high-level and fewer
  - Suggestions included
    - Include specificity of QO in quality risks
    - Clarify circumstances when additional QO should be established
    - More explicit in the standard that additional QO are not always required
    - Change the requirement to “a consideration” of whether additional QO are necessary

**Q6(b) & Q6(b)(i) Approach for Establishing Quality Objectives**



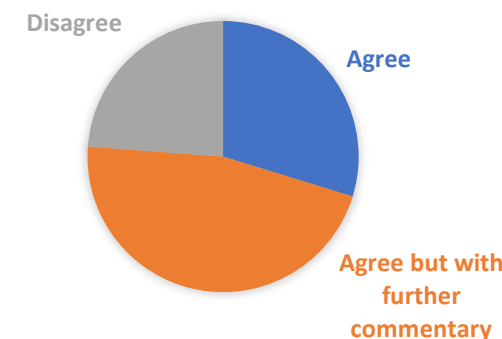
**Q6(b)(ii) Additional Quality Objectives Beyond Those Required by the Standard**



# Identify and Assess Quality Risks (QR)

- MG:
  - QR with remote likelihood / significant impact should be considered by firms
  - Other enhancements needed:
    - Assess changes in the external environment and a firm's own business model, need to be dynamic
    - Take findings from regulators into account as part of identifying and assessing QR
- Other respondents:
  - A threshold leads to a consistent approach, standard supports enhanced understanding of QR
  - Concerns about the threshold, i.e., “reasonably possible” and “more than remote”
  - Clarify meaning of “significant effect on the achievement of a QO”
  - Process for identifying and assessing QR overly prescriptive and does not provide flexibility - 2-step process is confusing and overengineered
  - Lack of required QR – illogical
    - Suggestions to repurpose required responses and granularity of QO or provide examples of QR
  - Clarity needed on how to document
  - General need for guidance

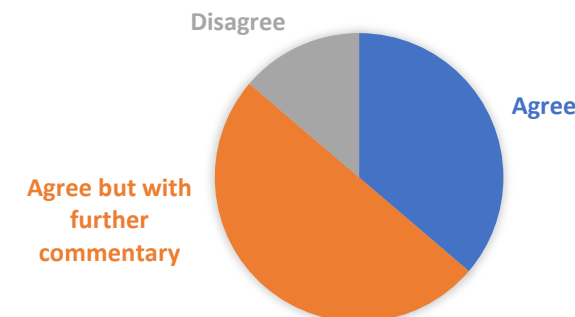
## Q6(c) Process for the Identification and Assessment of Quality Risks



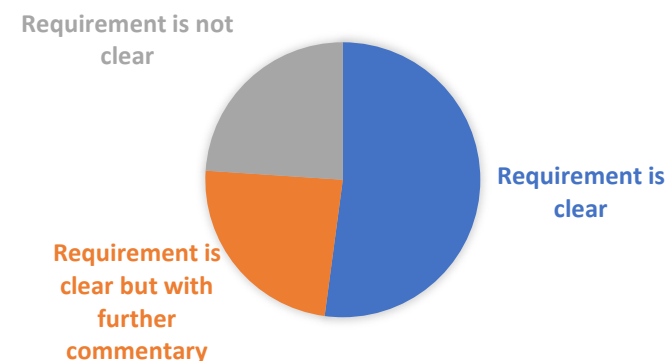
# Design and Implement Responses

- MG:
  - Firms may be overly focused on required responses
  - Responses should be more proactive and preventative
- Other respondents:
  - Responses prescriptive = checklist mindset, limited tailoring
  - Firms may “backfill” QR to match responses – perpetuates inappropriate QR
  - Inconsistency in (or lack of) responses across components – appears some components more important than others
  - Firms should not be expected to design and implement additional responses in all circumstances, i.e., responses in the standard may be sufficient
  - Varying views on how to deal with responses
    - Application material vs. requirements
    - Repurpose as QR
    - Other suggestions to clarify requirement to design and implement additional responses

## Q6(d) & Q6(d)(i) Approach for Designing and Implementing Responses



## Q6(d)(ii) Requirements to Design and Implement Additional Responses



## ISQM 1 TF's Consideration of Four Significant Issues

The ISQM 1 TF has developed the following proposals to address the scalability and complexity of Proposed ISQM 1:

1. The components and structure of Proposed ISQM 1
2. How Proposed ISQM 1 should address QO, QR and responses
3. How the standard addresses the FRAP
4. The scope of firms and services covered by Proposed ISQM 1

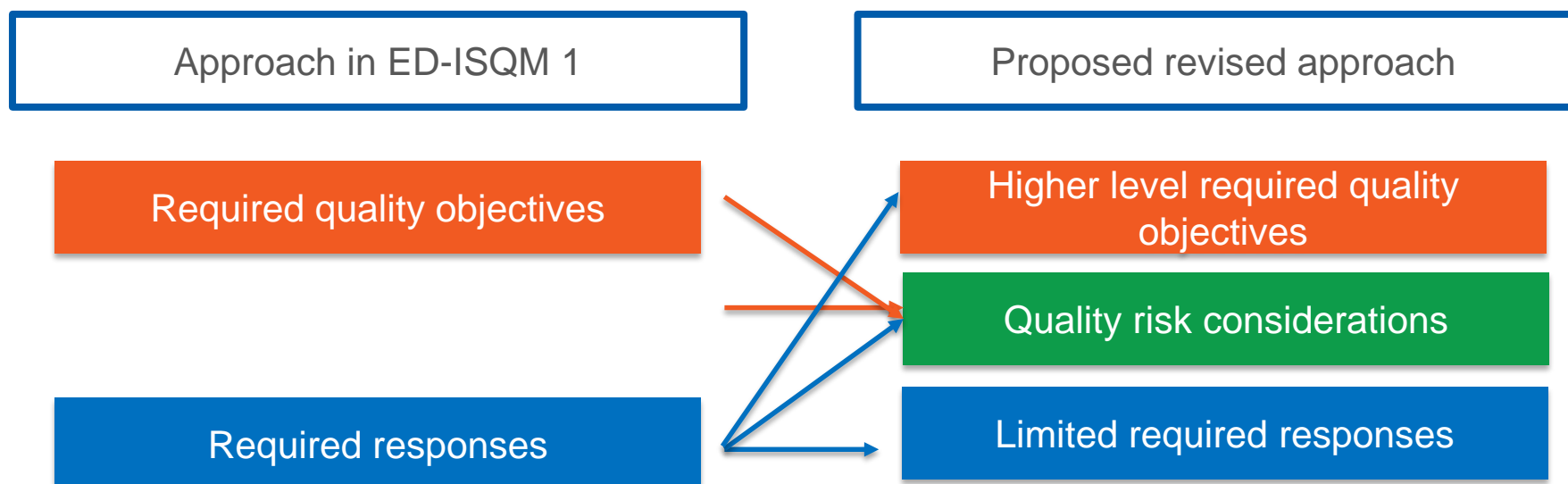
## Proposal 1: The Components and Structure of Proposed ISQM 1

- Improve Proposed ISQM 1 to differentiate between:
  - How the system is managed (process) – FRAP and M&R
  - What needs to be managed (criteria) – all other components
- Adjust how the FRAP relates to M&R – propose that FRAP is not applied to M&R, i.e., QO and QR not needed for the M&R component
  - However, adjust requirements in M&R to retain concept that firm may need to do more than what is required by the standard
- Reorder various aspects of Proposed ISQM 1 to simplify the standard and clarify how FRAP relates to the other components



## Proposal 2: How Proposed ISQM 1 Should Address QO, QR and Responses

- Revise QO to be higher level - may result in fewer QO
- Introduce “quality risk considerations” – developed from:
  - Details from QO that will no longer be included in the QO
  - Certain responses, repurposed as “quality risk considerations”
- Reduce responses (may be duplicated in a QO, or included in a “quality risk consideration”)



## Proposal 3: How the Standard Addresses the FRAP

- Simplify the FRAP:
  - Condense 2-step process of identifying and assessing QR into a single requirement (AM will acknowledge that sometimes this may be a 2-step process)
  - Refocus the requirement away from being process-driven, to outcome-based
- Address threshold for identifying and assessing QR:
  - Relocate QR threshold out of requirements, to simplify the requirements
  - Remove reference to “more than remote”, but mixed views about whether to retain “reasonably possible”
  - Introduce application material to address concept of spectrum of risk
  - Adjust element of the threshold that addresses the magnitude of effect – needs to be revised to be appropriate for the new “higher level” QO
- Revise requirement for firm to establish additional QO to reflect a bottom-up approach

## Proposal 4: The Scope of Firms and Services Covered by Proposed ISQM 1

- Develop separate requirements for management of quality for related services engagements:
  - Locate in a separate standard
  - Standard would apply to all firms that perform related services engagements, i.e., firms would apply:
    - Proposed ISQM 1 to managing quality for audits, reviews and other assurance engagements
    - New standard to managing quality for related services engagements

# Questions for Representatives

## Question 1:

Do representatives support the proposals outlined in Agenda Item C.2 to address the scalability and complexity of Proposed ISQM 1, including:

- (a) Reordering the components of the standard to improve the readability of the standard, and clarifying that “the firm’s risk assessment process” and “monitoring and remediation” are processes in nature?
- (b) Revising the approach to required quality objectives, quality risks and responses in the components, i.e.:
  - (i) Revising the quality objectives to be higher level, which may result in fewer quality objectives;
  - (ii) Introducing quality risk considerations; and
  - (iii) Reducing the required responses.
- (c) Simplifying the requirements addressing the identification and assessment of quality risks?
- (d) Developing a separate standard dealing with quality management over related services engagements?

## Questions for Representatives

### Question 2:

Do representatives have views about additional actions the IAASB should take to address the scalability and complexity of Proposed ISQM 1?



## Feedback on Other Aspects of ED-ISQM 1: Initial Impressions

- Support for references to the public interest in the standard with suggestions to clarify meaning
- Governance and leadership – overall support, but concerns on prescriptiveness / scalability of requirements
  - Mixed views about a requirement to assign responsibility for relevant ethical requirements and/or independence
- Technological resources - overall support for how addressed in ED-ISQM 1
- Communication with external stakeholders – mixed views
  - Concerns too prescriptive as refers too directly to transparency reports; others suggesting standard should do more in addressing external communication
- Monitoring and remediation – overall support, but concerns about scalability, level of prescriptiveness and whether will drive innovation
  - Mixed views on the requirement addressing inspection of completed engagements
  - Framework for evaluating findings and identifying deficiencies lacks clarity
  - Support for new requirement to investigate root causes
  - Many challenges identified regarding annual evaluation of SOQM, including being too onerous for SMPs

## Feedback on Other Aspects of ED-ISQM 1: Initial Impressions (continued)

- Networks - overall support for proposals
- Service providers - overall support for addressing service providers in the standard
  - Concerns about the scope of service providers and obtaining information from service providers
- Strong call for additional support materials and guidance, particularly guidance supporting first time implementation, SMPs, monitoring and remediation, root cause analysis and documentation



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