

### Proposed ISQM 1<sup>1</sup>: Issues and Recommendations

#### Objective of the IAASB discussion

The objective of this Agenda Item is to:

- (a) Provide an overview of respondents' feedback on the Exposure Draft (ED) of ISQM 1 (ED-ISQM 1).
- (b) Obtain the Board's views about how the ISQM 1 Task Force's (TF) proposes to address some of the significant issues and concerns raised by respondents. In particular, the ISQM 1 TF is seeking the Board's views on how the ISQM 1 TF proposes to address:
  - i. The overall scope of firms and services covered by Proposed ISQM 1.
  - ii. The structure of Proposed ISQM 1.
  - iii. How Proposed ISQM 1 deals with quality objectives, quality risks and responses.
  - iv. How the standard deals with the firm's risk assessment process.

#### A. Introduction

1. Ninety-nine (99) comment letters were received in response to ED-ISQM 1 from a variety of stakeholders across many regions, as follows:

Monitoring Group	4
Investors and Analysts	2
Regulators and Audit Oversight Authorities	4
National Auditing Standard Setters	14
Accounting Firms	25
Public Sector Organizations	10
Member Bodies and Other Professional Organizations	37
Academics	1
Individuals and Others	2

Global	25
Asia Pacific	17
Europe	29
Middle East and Africa	8
North America	16
South America	4

See Appendix 2 of this paper for a list of respondents to ED-ISQM 1.

2. In general, there was support for the new quality management approach (QMA), however there were strong concerns about the scalability of ED-ISQM 1, particularly related to the perceived prescriptiveness of the standard and its overall length. There were also extensive concerns expressed about the time and resources needed to implement the standard in its current form, with respondents asking for further guidance and support materials to support implementation, especially in the application of the firm's risk assessment process.

<sup>1</sup> Proposed International Standard on Quality Management (ISQM) 1 (Previously International Standard on Quality Control 1), *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*

3. The ISQM 1 TF reflected on all comments received on ED-ISQM 1, and the Chair of the ISQM 1 TF will present an overview of the feedback to the Board in September 2019 (see **Agenda item 4–A**). In this issues paper, a summary of the respondents' views has been included *only* for the questions from the ED listed below, which the ISQM 1 TF considers priority issues based on the significance of the feedback received. The feedback has been summarized in Section B of this paper as follows:  
  
Section B.1. Question 1 and related sub-questions: Quality management approach (QMA), benefits of ED-ISQM 1 and scalability.  
  
Section B.2. Question 2: Implementation challenges.  
  
Section B.3. Question 4: Components and structure of ED-ISQM 1.  
  
Section B.4. Question 6 and related sub-questions: The firm's risk assessment process.  
  
4. Respondents' views on the questions listed above provide context for the proposals in this paper, on which the ISQM 1 TF is seeking clear direction from the Board. The proposals are set out in Section C of this paper as follows:  
  
Section C.1. The components and structure of Proposed ISQM 1.  
  
Section C.2. How Proposed ISQM 1 deals with quality objectives, quality risks and responses.  
  
Section C.3. How the standard deals with the firm's risk assessment process.  
  
Section C.4. The scope of firms and services covered by Proposed ISQM 1.  
  
5. In determining what proposals to present to the Board in September 2019, the ISQM 1 TF had considered the comments on networks. The ISQM 1 TF noted the general support from respondents for the requirements directed at firms, however observed suggestions from three respondents (two monitoring group members and a firm) that requirements are also needed for networks. The ISQM 1 TF notes the importance of this issue, however, at this time, further deliberation is needed before any proposals can be presented to the IAASB.

*Other Agenda Items Accompanying This Paper and Appendices to this Paper*

6. **Agenda item 4–A** contains an overview of the feedback on ED-ISQM 1, which will be presented to the Board.
7. **Agenda item 4–B (which comprises of Agenda item 4–B.1 to Agenda item 4–B.12)** provides a summary of the analysis for each question summarized in Section B of this paper.
8. **Agenda item 4–C.1 to Agenda item 4–C.4** includes the Nvivo reports that include the actual comments from the respondents on the questions summarized in Section B of this paper.
9. Appendix 1 provides an overview of the ISQM 1 TF's activities.
10. Appendix 2 contains a list of respondents to ED-ISQM 1.
11. Appendix 3 explains how the Nvivo analysis was undertaken for ED-ISQM 1 and contains other information relevant to the summary of respondent views outlined in this paper.
12. Appendix 4 points out, for each question raised in ED-ISQM 1 and other related topics, when the ISQM 1 TF plans to present each question and topic to the Board.

13. For ease of reference, Appendix 5 provides the paragraphs from ED-ISQM 1 that are referenced or discussed in this paper.

#### *Structure of the Board Discussion*

14. The Board discussion will follow the following order:
  - (a) The Chair of the ISQM 1 TF will provide a presentation summarizing all feedback received on ED-ISQM 1. (**Agenda item 4–A**)
  - (b) The Chair of the ISQM 1 TF will provide a brief introduction to each proposal in Section C, followed by Board input on the questions in each Section. The questions will follow the sequence as set out in this paper and will be asked within each Section.

### **B. Summary of Respondents' Views on Matters Addressed in this Issues Paper**

#### **B.1 Quality Management Approach (QMA), Benefits of ED-ISQM 1 and Scalability**

*Overview of Responses to Question 1(a): Do You Support the New QMA? If Not, What Specific Attributes of This Approach Do You Not Support and Why?*

15. **Agenda item 4–B.1** summarizes the feedback from respondents on the concept of the QMA and includes a summary of themes identified from the comments. Overall:
  - (a) 55% of respondents supported the new QMA and 27% of respondents, including two monitoring group (MG) members, supported the new QMA subject to additional comments.
  - (b) 3% of respondents did not support the new QMA.

#### *Further Comments from MG Members*

16. One MG member noted that the new risk-based approach reflects the evolving environment in which firms operate, the intensifying focus on quality and the increasing expectations of firms' stakeholders. However, this respondent suggested that the standard should go further in requiring firms to be proactive and provided more specific recommendations to achieve this (the suggestions related to the required responses and monitoring and remediation). Two other respondents, both from the "regulators and audit oversight authorities" respondent group, echoed similar comments.
17. Two MG members highlighted the need for the standard to be developed in a manner that supports effective oversight and enforcement action. One respondent raised concern about the lack of enforceable criteria in the standard, while the other emphasized their concerns about the level of judgment embedded within the standard that may not support oversight and enforcement.

#### *Further Comments from Other Respondents*

18. Respondents who supported the QMA indicated that the new QMA approach would encourage more tailored systems of quality management and promote a proactive approach to managing quality and changing circumstances, thereby stimulating continual improvement and responsiveness. Respondents also noted that the QMA would facilitate an integrated and thinking approach to managing quality and emphasized that a new mindset would be needed in which quality is an embedded and active aspect of a firm's culture. Respondents also highlighted that the new approach would help firms meet challenges facing the profession, including changes in the economic, technological, social and regulatory aspects of the markets in which firms operate.

19. Respondents who disagreed with the new QMA, who were all from the “national standard setters” stakeholder group, indicated that they support the concept of a QMA but ED-ISQM 1 does not reflect what they consider to be a true quality management system. Other respondents who supported the QMA also raised concerns with how the QMA has been embedded in ED-ISQM 1. In particular, respondents indicated that ED-ISQM 1 is a hybrid of a risk-based approach and prescriptive requirements, which undermines the proper application of a risk-based approach. They further noted the length and complexity of the standard, highlighted the lack of scalability and emphasized the difficulties that would be experienced in implementing the standard in its current form (see also section B.2 below). Multiple respondents raised concern about the application of the QMA to small-and-medium sized practitioners (SMPs).
20. Respondents provided various suggestions to improve the standard, including:
  - (a) Adjusting the required quality objectives and required responses and more explicitly addressing quality risks, for example, by removing the required responses, combining quality objectives and responses, reducing the granularity of the quality objectives and responses, or introducing quality risks. Section B.4 below further explores respondents’ comments on these proposals.
  - (b) Restructuring the standard, such as placing the firm’s risk assessment process first and removing certain components and integrating them into other components. Section B.3 below further explores respondents’ comments on the components and structure of the standard.
  - (c) Reducing the requirements, for example, through bifurcating the requirements into two standards (one dealing with the risk-based approach and another containing the detailed quality objectives and responses) or placing the quality objectives or responses in an appendix.
  - (d) Placing more emphasis on behavioral outcomes that influence quality, such as dealing with change, ongoing automation and meeting stakeholder needs, and less on documented processes and controls that are more easily designed, observed and monitored.
  - (e) Placing more emphasis on aligning quality management with the firm’s business strategy and incorporating quality management into enterprise risk management.
  - (f) Using the same approach that is being considered in Changes Made to ED-315<sup>2</sup> (i.e., the what / how / why approach).

There were also suggestions to provide guidance about the new QMA.

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<sup>2</sup> Throughout this paper, reference to Changes Made to ED-315 means the revisions being made by the ISA 315 Task Force to Proposed International Standard on Auditing (ISA) 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement*, in response to comments received on that ED.

*Overview of Responses Question 1(b): In Your View, Will the Proposals Generate Benefits for Engagement Quality as Intended, Including Supporting the Appropriate Exercise of Professional Skepticism at the Engagement Level? If Not, What Further Actions Should the IAASB Take to Improve the Standard?*

21. **Agenda item 4–B.2** summarizes the feedback from respondents on the benefits for engagement quality and how professional skepticism was addressed in ED-ISQM 1 and includes a summary of themes identified from the comments. Overall:
- (a) 29% of respondents indicated that the proposals would likely contribute positively to engagement quality and support the exercise of professional skepticism at the engagement level. 45% of respondents also had the same view but had further comments about these potential benefits or how professional skepticism is addressed further explained below.
  - (b) 9% of respondents, mostly representing “member bodies and other professional organizations” and “national standard setters,” thought that there could be a negative impact on engagement quality, or that the standard would not support the exercise of professional skepticism.

#### Comments from MG Members

22. Two MG members emphasized their support for ED-ISQM 1 recognizing the importance of professional skepticism to audit quality. One MG member further encouraged the IAASB to reflect professional skepticism in the governance and leadership component of ED-ISQM 1.

#### Benefits for Engagement Quality

23. Respondents who indicated that ED-ISQM 1 would generate benefits for engagement quality highlighted that the firm’s system of quality management is the foundation for consistently delivering high quality engagements. They also emphasized how governance and leadership is critical to embedding and supporting a culture of quality and a focus on professional skepticism. Respondents also commented that allocating appropriate resources is important to preventing impediments to professional skepticism.
24. Respondents broadly noted that the effect of the standard and expected benefits would vary from firm to firm, further emphasizing that:
- (a) Some firms have already adopted risk-based approaches to managing quality.
  - (b) The extent of benefit would depend on the mindset and dedication of firms in adopting the new QMA, and whether regulators embrace a more tailored and risk-based approach.
  - (c) Guidance to support implementation would be essential so that the benefits of the standard are realized.

However, there were concerns that the benefits may be limited for SMPs, or cause quality to decrease for SMPs.

25. As highlighted in the summary on question 1(a) above, and on the summaries of the questions that follow, there were concerns about the prescriptiveness of ED-ISQM 1. These concerns were also echoed in response to question 1(b), with respondents noting that the level of prescriptiveness could perpetuate a “checklist mindset,” to the detriment of improving engagement quality and achieving the objective of the standard.

26. Respondents also:
- (a) Highlighted that requirements that may be seen as onerous (i.e., the prescriptiveness of the standard and the level at which quality risks are expected to be identified) will require extensive documentation.
  - (b) Emphasized the need for resources to implement the requirements and that firms may need to refocus resources away from the performance of engagements in order to fulfill the requirements of the standard. As a result, there were concerns about the impact on engagement quality.
  - (c) Urged the IAASB to undertake a cost-benefit analysis to confirm that the intended benefits of the standard will outweigh the anticipated costs.
27. Other comments included the need for more robust requirements in ED-ISQM 1 that address consequences for non-compliance, in order that there is more accountability of firm personnel to influence behavior.

#### Professional Skepticism

28. Respondents encouraged the IAASB to reflect professional skepticism in the governance and leadership component of ED-ISQM 1.
29. Other various suggestions from respondents included:
- (a) Addressing professional skepticism in other aspects of ED-ISQM 1, such as acceptance and continuance and relevant ethical requirements.
  - (b) Developing examples of how key areas of the components may directly or indirectly support the exercise of professional skepticism by engagement teams.
  - (c) Referring to the professional skepticism provisions in ED-220.<sup>3</sup>
  - (d) Including a more explicit reference to IES 8,<sup>4</sup> since it addresses the behaviors that support professional skepticism.
30. Other comments on professional skepticism highlighted that addressing professional skepticism in the standards is unlikely to influence behavior. Furthermore, there were respondents who noted confusion about the conditional use of “professional skepticism” in ED-ISQM 1 (i.e., the use of “when applicable to the type of engagement”).

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<sup>3</sup> Proposed ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*

<sup>4</sup> International Education Standard (IES) 8, *Professional Competence for Engagement Partners Responsible for Audits of Financial Statements (Revised)*, issued by the International Accounting Education Standards Board.

*Overview of Responses Question 1(c): Are the Requirements and Application Material of Proposed ED-ISQM 1 Scalable Such That They Can Be Applied by Firms of Varying Size, Complexity and Circumstances? If Not, What Further Actions Should the IAASB Take to Improve the Scalability of the Standard?*

31. **Agenda item 4–B.3** summarizes the feedback from respondents on the scalability of ED-ISQM 1 and includes a summary of themes identified from the comments. Overall, there were mixed views about whether ED-ISQM 1 is scalable with:
- (a) 13% of respondents indicated that the standard is scalable. 34% of respondents, including one MG member, also indicated that the standard is scalable but had further comments or concerns further explained below.
  - (b) 43% of respondents indicating that the standard is not scalable, for the reasons further explained below.

#### Comments from MG Members

32. A member of the MG noted the importance of larger firms needing to “scale-up,” i.e., doing significantly more in addressing matters of audit quality beyond the minimum requirements as defined in ED-ISQM 1.
33. Another MG member observed the length of the standard and the proposal to develop additional guidance. This respondent therefore encouraged (i) a critical review of the application material and additional guidance, and (ii) consideration of whether the relevant requirements could rather be improved or clarified.

#### Comments from Other Respondents

34. Respondents across all other stakeholder groups emphasized the need for examples or guidance to demonstrate how the standard is scalable, with further suggestions on aspects of the standard where the examples or guidance would be most helpful. However, respondents further commented as follows:
- (a) Respondents cautioned that the need for guidance and examples may indicate that there is a lack of clarity and true scalability in the standard or that more work is needed on the standard. Others similarly cautioned that guidance or examples should not be used as a substitute for clarifying the standard.
  - (b) The status of any additional materials outside of the standard needs to be clear so that they are not misunderstood or misused (e.g., misused as checklists or misunderstood as de facto requirements).
35. As highlighted in the summaries on questions 1(a) and 1(b) above, and for the questions that follow, there were concerns about the prescriptiveness of ED-ISQM 1. These concerns were also echoed in response to question 1(c), with respondents expressing views that:
- (a) The level of prescriptiveness of the quality objectives and responses does not facilitate a scalable approach. There was a call from respondents to reduce the number of quality objectives and make them more overarching. Section B.4 below further explores respondents’ comments on the firm’s risk assessment process.

- (b) The absence of required quality risks suggests that the required responses are not risk-based and therefore not truly scalable. Section B.4 below further explores respondents' comments on the firm's risk assessment process.
  - (c) The firm's risk assessment process appears prescriptive, and the threshold prescribed in the standard at which quality risks need to be identified is too low. Section B.4 below further explores respondents' comments on the firm's risk assessment process.
  - (d) The standard creates a documentation burden, particularly around documenting why certain requirements are not relevant to the firm, and the firm's risk assessment process.
  - (e) The standard has been written for large firms or firms performing audit engagements for entities with a higher level of public interest, and this creates a burden for SMPs who would need to understand the full standard and explain and document why a requirement is not relevant in their circumstances. Respondents therefore called for a "bottom-up" approach, rather than a "top-down" approach, with others indicating the need for certain requirements to be more clearly conditional. A respondent noted that the IESBA Code<sup>5</sup> is an example of how separate sections are used to establish different requirements for different engagements.
36. Respondents also addressed the application of ED-ISQM 1 by firms who provide non-audit services, indicating particular concern for firms who perform related services engagements. Respondents commented as follows:
- (a) There is an increasing trend away from audits, driven by the increasing frequency and size of audit exemption thresholds. The range of non-audit engagements conducted under the IAASB Standards is wide in relation to the nature, complexity and public interest aspects of engagements.
  - (b) The Invitation to Comment (ITC), *Enhancing Audit Quality: A Focus on Professional Skepticism, Quality Control and Group Audits*, highlighted multiple key public interest issues, which were largely focused on audit engagements. ED-ISQM 1 also has a strong undertone of audit engagements throughout, with little to no mention of non-audit engagements.
  - (c) ED-ISQM 1 is not suitable for non-audit engagements, particularly related services engagements. Further consideration is needed of the implications of ED-ISQM 1 for firms performing these engagements, and of any potential unintended consequences to the performance of these engagements. It was also highlighted that firms who perform only related services engagements are less familiar with a risk-based model, exacerbating their challenges with the new QMA.
37. As a result, there were various suggestions to address the applicability of ED-ISQM 1 as it relates to managing quality for non-audit engagements or audit engagements of less complex entities, including:
- (a) A separate standard for managing quality for non-audit engagements or audits of less complex entities, such as a standard similar to extant ISQC 1.<sup>6</sup>

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<sup>5</sup> International Ethics Standards Board for Accountants (IESBA) *International Code of Ethics for Professional Accountants (including International Independence Standards)*

<sup>6</sup> International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements and Related Services Engagements*

- (b) “Freezing” extant ISQC 1 so that it continues to be applicable for managing quality for non-audit engagements or audits of less complex entities.
  - (c) Separate requirements in ED-ISQM 1 for managing quality for non-audit engagements or audits of less complex entities.
38. In addition to the level of prescriptiveness of the standard, respondents highlighted that the length and complexity of the standard poses problems for scalability. Respondents provided various general suggestions, including:
- (a) Simplifying the requirements, which would remove the need for extensive explanations in application material. Respondents also suggested bifurcating requirements so that the sentences are more succinct and less complex.
  - (b) Removing duplicative material, including the introduction, which was viewed by respondents as duplicative of the standard.
  - (c) Using certain explanations and diagrams from the Explanatory Memorandum, which in some cases were considered easier to understand than the standard itself.
  - (d) More clearly signposting the paragraphs that address scalability or giving more visibility to how the standard is scalable, including suggestions to reinstate the “considerations specific to smaller firms” paragraphs.
  - (e) Using the same approach that is being considered in the Changes Made to ED-315 (i.e., the what / how / why approach), as highlighted in the responses to question 1(a).
  - (f) Placing material outside of the standard in the basis for conclusions and supplementary guidance.
  - (g) “Digitizing” the standard to facilitate a bottom-up approach and improve navigation.

## B.2. Implementation Challenges

*Overview of Responses Question 2: Are There Any Aspects of the Standard That May Create Challenges for Implementation? If so, Are There Particular Enhancements to the Standard or Support Materials That Would Assist in Addressing These Challenges?*

39. **Agenda item 4–B.4** summarizes the feedback from respondents on the implementation challenges of ED-ISQM 1, and highlights that most respondents indicated there would be implementation challenges. **Agenda item 4–B.4** also provides a summary of themes where respondents considered there would be implementation challenges.

Comments from MG Members

40. MG members did not comment on this area.

Comments from Other Respondents

41. The most common challenge identified by respondents is the time, resources and expertise firms will need to properly implement and maintain a system of quality management in accordance with ED-ISQM 1. As highlighted in the summary on question 1(b), there was a call for a cost-benefit analysis to be undertaken, driven by respondents' concerns about the resources needed to implement ED-

ISQM 1 in its current form. Respondents commented further on the issue of time and resources as follows:

- (a) The time and resources will be particularly challenging on initial implementation. In this regard, respondents emphasized their concerns about the proposed implementation period. **Agenda item 5** summarizes respondents' views on the proposed implementation period, which was a question in the overall explanatory memorandum, [\*The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level\*](#).
  - (b) Applying the firm's risk assessment process will be particularly time consuming and resource intensive, as well as piloting and testing systems before the implementation date.
  - (c) It will take time to entrench a firm-wide mindset change, and to influence the culture of the firm.
  - (d) A respondent noted the need for clear communication from the IAASB about the extent of incremental effort needed to implement ED-ISQM 1 to avoid a misconception that the scalability benefits will mean less effort for firms.
42. As with the responses to other questions, respondents also emphasized their concerns about the prescriptiveness, complexity and length of the standard in the context of implementation challenges. In addition to the impact these factors have on resource needs, respondents noted that the length and complexity of the standard results in it being difficult to read and understand, and may cause firms to lose sight of the "big picture." It was also noted by a respondent that in some jurisdictions the standards are legislative instruments, and the prescriptiveness of requirements therefore exacerbates the challenges in demonstrating compliance with the standard. Respondents provided various suggestions to simplify the standard and reduce its length and prescriptiveness, which have already been summarized in Section B.1 of this paper.
43. Respondents emphasized the firm-wide impact of ED-ISQM 1 and the challenges this may create including:
- (a) The organizational restructuring that may be needed in many firms, including revising leadership structures, re-defining roles and responsibilities and fully transitioning individuals into these new roles and responsibilities.
  - (b) The changes to, or development of new, information technology (IT) systems to support the requirements of the standard, particularly for networks who will need to use IT systems to support consistent implementation across the network.
  - (c) The extent to which firms will need to involve other "non-assurance" functions, such as human resources and IT.
44. Respondents across all stakeholder groups also raised concerns about the professional judgment that firms will exercise in designing, implementing and operating the system of quality management. A respondent from the "regulators and audit oversight authorities" stakeholder group noted the need for documentation of professional judgments to support inspection processes. On the other hand, respondents across other stakeholder groups expressed concern about the level of documentation that will be expected to support firms' professional judgments, and further emphasized the challenges that arise from differing interpretations between firms and regulators. Respondents therefore urged the IAASB to clarify certain aspects of the standard, such as the firm's risk assessment process.

45. The firm's risk assessment process was highlighted by respondents as being particularly challenging, especially the identification and assessment of quality risks. Respondents commented variously on the challenges associated with the firm's risk assessment process, including regarding:
- (a) The level of granularity of the required quality objectives, and the extent to which firms are expected to identify additional quality objectives.
  - (b) How to identify and assess quality risks.
  - (c) The threshold prescribed in the standard at which quality risks need to be identified, which was viewed by certain respondents as too low.
  - (d) Linking the quality objectives to quality risks and responses.
46. There were also numerous comments on implementation challenges related to monitoring and remediation. Respondents highlighted implementation challenges with (i) performing a root cause analysis; (ii) identifying and evaluating findings and deficiencies; and (iii) firm leadership's annual evaluation of the system of quality management. As the issues are similar to the comments raised in response to question 12 and the related sub-questions,<sup>7</sup> these themes will be further explored when monitoring and remediation is presented to the IAASB in December 2019.
47. Respondents observed that documentation is an area likely to cause implementation challenges, and commented further as follows:
- (a) There were suggestions to clarify the documentation requirements, especially regarding (i) the firm's risk assessment process; and (ii) the firm's evaluation of network requirements and services and service providers. Respondents also suggested developing examples to demonstrate documentation, particularly for SMPs who may have more informal systems of quality management.
  - (b) On the other hand, there were also concerns that the documentation requirements may be onerous, particularly those regarding the quality objectives, quality risks and responses. It was observed that documenting the relationship of quality objectives, quality risks and responses will be particularly difficult.
  - (c) There were observations that the prescriptiveness of the standard creates a burden for SMPs, who would need to explain and document why a requirement is not relevant in their circumstances (highlighted also in the summary on question 1(c)).
  - (d) A respondent noted that documenting actions and decisions (refer to the definition of responses in paragraph 19(t) of ED-ISQM 1) is particularly challenging, for example, actions related to culture.
48. Respondents also noted implementation challenges regarding networks, with the major theme of these comments focused on consistent application across the network and how the requirements apply in varying network structures. Respondents noted the challenge for networks in developing a consistent global approach, while also needing to reflect the nature and circumstances of each firm. One respondent emphasized the difficulties in consistency that are created by differing professional standards across the network, and therefore encouraged the IAASB to continue its liaison with other standard setters. Respondents also mentioned challenges related to service providers, such as the

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<sup>7</sup> Question 12 of ED-ISQM 1 and the related subquestions addressed monitoring and remediation.

scope of services that need to be considered and challenges in obtaining information from service providers. The issues related to networks and service providers will be further explored when these topics are presented to the IAASB for further consideration.

#### Support Materials

49. A clear theme emerged about the need for clarity about how ED-ISQM 1 differs from extant ISQC 1. In particular, respondents noted:
- (a) Such clarity is needed in order to better demonstrate how a system of quality management under ED-ISQM 1 differs from what firms have in place today.
  - (b) Firms need assistance in working out what they can use from their existing systems and the lack of clarity of the differences may create the perception that firms should disregard their current systems.
50. Respondents also commented variously on other areas where additional support materials or guidance would be useful, in response to question 2 and many other questions. The ISQM 1 TF will consider these comments and the most appropriate solutions, including the form and content of support materials, after further progression on the standard has been made.

### B.3. Components and Structure of ED-ISQM 1

*Overview of Responses Question 4: Do You Support the Eight Components and the Structure of ED-ISQM 1?*

51. **Agenda item 4–B.5** summarizes the feedback from respondents on the components and structure of ED-ISQM 1 and includes a summary of themes identified from the comments. Overall:
- (a) 49% of respondents supported the components and structure. 35% of respondents also supported the components and structure but had further comments or concerns further explained below.
  - (b) 14% of respondents did not support the components and structure for the reasons further explained below.

#### Comments from MG Members

52. MG Members did not comment on the components overall and the structure of ED-ISQM 1, however their specific comments on the components will be analyzed as part of the components when those are presented to the Board for discussion.

#### Comments from Other Respondents

53. Respondents who supported the eight components noted that the components provide a logical organization for the standard to facilitate navigation. Respondents also highlighted their support for the increased emphasis in ED-ISQM 1 on the interrelationship of the components and the flexibility provided to firms in organizing their systems (i.e., that firms are not required to organize their systems according to the components).
54. On the other hand, concerns and suggestions from respondents on the components and structure of ED-ISQM 1 included the following general themes:

- (a) Views that certain components are processes in nature and therefore should not be described as components or treated in the same way as other components.

Respondents noted that the firm's risk assessment process and monitoring and remediation are both processes in nature and should be described and treated as such. This includes not applying the firm's risk assessment process to monitoring and remediation. A respondent described the distinction in components as "what needs to be managed" and "how it needs to be managed."

- (b) Information and communication are necessary for other components to function and therefore should be integrated into the other components.

Respondents noted that information and communication are overarching factors needed for all other components to operate and should be considered throughout the firm's system of quality management. Respondents recommended that relevant considerations for information and communication be embedded into the other components, rather than being addressed separately.

- (c) Suggestions that the firm's risk assessment process should be the first component preceding governance and leadership.

Respondents agreed that governance and leadership is of paramount importance. However, respondents noted that the firm's risk assessment process applies to everything that follows in the standard and placing the component first would assist in providing appropriate context to the required quality objectives and responses and improve the readability and understandability of the standard. Respondents also suggested that this structure would alleviate the need for the lengthy introduction.

An alternative suggestion from a respondent was to include an explanation in the application material of why governance and leadership is placed first.

- 55. Respondents also highlighted that the introductory paragraphs are lengthy and could be reduced, and also suggested including the diagram of the components from the explanatory memorandum in the standard. There were also recommendations to improve how the standard addresses the iterative nature of the components.

#### **B.4. The Firm's Risk Assessment Process**

*Overview of Responses Question 6: Do you believe that application of a risk assessment process will drive firms to establish appropriate quality objectives, quality risks and responses, such that the objective of the standard is achieved?*

- 56. Not all respondents provided commentary on question 6 and focused more on the related sub-questions. **Agenda item 4–B.6** summarizes the feedback from respondents on question 6 and includes a summary of themes identified from the comments. Overall:

- (a) 40% of respondents considered that the firm's risk assessment process would drive firms to establish appropriate quality objectives, quality risks and responses, such that the objective of the standard is achieved. 36% of respondents also expressed this view but had further comments or concerns further explained below.

- (b) 14% of respondents did not consider that the firm's risk assessment process would drive appropriate outcomes.

Comments from MG Members

- 57. Members of the MG did not comment on this area.

Comments from Other Respondents

- 58. Further comments provided by respondents highlighted themes already highlighted in other questions, including:
  - (a) Concerns about the complexity of the firm's risk assessment process, that it is overly burdensome, and will be particularly challenging for SMPs.
  - (b) Observations that the prescriptiveness of the standard is unlikely to drive appropriate outcomes and tailoring by firms (i.e., appropriate quality objectives, quality risks and responses).
  - (c) The need for additional guidance.
- 59. A respondent observed that the example provided by the IAASB as an accompanying document to the ED demonstrated the prescriptiveness of the standard, since even in a simple example, it highlighted the extent of quality objectives, quality risks and responses that would also need to be documented.
- 60. Respondents also suggested that the standard more robustly address how frequently a firm should re-assess its quality objectives, quality risks and responses, and suggested that a periodic re-evaluation should be required (the length of the suggested period varied).

*Overview of Responses Question 6(a): Do you agree that the firm's risk assessment process should be applied to the other components of the system of quality management?*

- 61. **Agenda item 4–B.7** summarizes the feedback from respondents on the application of the firm's risk assessment process to the other components and includes a summary of themes identified from the comments. Overall:
  - (a) 68% of respondents supported applying the firm's risk assessment process to the other components. 8% of respondents also had this view but had further comments or concerns further explained below.
  - (b) 12% of respondents did not support the approach of applying the firm's risk assessment process to the other components for the reasons further explained below.

Comments from MG Members

- 62. Members of the MG did not comment on the application of the firm's risk assessment process to the components.

Comments from Other Respondents

- 63. A respondent who supported the application of the firm's risk assessment process to the other components also highlighted their support for providing firms with the flexibility in terms of how they

will apply the firm's risk assessment process, i.e., applying the process individually to each component, or to individual business units or service lines.

64. Respondents who disagreed, or agreed but with comments and suggestions, highlighted their views expressed on question 4 regarding the structure of the components (i.e., that some components are processes). Furthermore, consistent with the comments highlighted in Section B.3, respondents indicated that the firm's risk assessment process should not be applied to the monitoring and remediation process and information and communication components. It was noted that given the requirements in monitoring and remediation are already so specific, requiring firms to establish quality objectives, quality risks and responses will cause circularity. There were also comments that the resources component is of a similar nature to the information and communication component and therefore should also be an overarching component, but these comments were more isolated.
65. Respondents also commented on the positioning of the firm's risk assessment process component, noting that, as presented, it is not clear that it is applied to the other components. There were also suggestions to clarify that the firm's risk assessment process may be applied in a variety of ways (as explained in the explanatory memorandum).

*Overview of Responses Question 6(b): Do you support the approach for establishing quality objectives?  
In particular:*

- (a) *Are the required quality objectives appropriate?*
- (b) *Is it clear that the firm is expected to establish additional quality objectives beyond those required by the standard in certain circumstances?*
66. **Agenda items 4–B.8 and 4–B.9** summarize the feedback from respondents on the questions related to the quality objectives and include a summary of themes identified from the comments. Overall, with respect to the approach for establishing quality objectives and the appropriateness of the required quality objectives:
  - (a) 58% of respondents supported the approach for establishing quality objectives and the required quality objectives. 19% of respondents also had this view but had further comments or concerns further explained below.
  - (b) 23% of respondents disagreed with the approach for establishing quality objectives or the required quality objectives.

Overall, with respect to the requirement addressing the need for firms to establish additional quality objectives beyond those required by the standard:

- (a) 44% of respondents considered that the requirement to establish additional quality objectives is clear. 42% of respondents also had this view but had further comments or concerns further explained below.
- (b) 13% of respondents did not consider the requirement to establish additional quality objectives to be clear.

Comments from MG Members

67. One member of the MG indicated that the standard does not provide clear direction on when and how additional quality objectives should be developed. This respondent also encouraged developing

requirements that support establishing more granular quality objectives to support the subsequent quality risk identification and assessment and responses, which was supported by another respondent from the “regulators and audit oversight authorities” stakeholder group.

#### Comments from Other Respondents

68. Respondents who supported the approach to quality objectives agreed with the IAASB’s view that the quality objectives in ED-ISQM 1 are comprehensive and, if properly addressed by a firm, will result in the system providing reasonable assurance that its objectives have been achieved. A respondent noted that the quality objectives give a steer to firms about the starting point while maintaining a risk-based approach. Another respondent noted their support for the outcome-based nature of the quality objectives and the flexibility within the standard whereby firms may decide that more granular quality objectives are appropriate.
69. However, consistent with the comments raised in response to other questions, other respondents raised concern about the prescriptiveness of the quality objectives, suggesting that there should be fewer quality objectives that are more principles-based and high level. Respondents noted that this approach would encourage firms to be more thoughtful about their quality risks and drive more proactivity. Respondents recommended retaining the specificity of the quality objectives through introducing “risk factors” (see comments below on question 6(c)) and also commented that certain quality objectives appeared to be quality risks or responses in nature.
70. With respect to the requirement to establish additional quality objectives:
- (a) Respondents called for clarity regarding circumstances when additional quality objectives should be established (this was similar to the MG views outlined in paragraph 67). Respondents suggested providing examples of additional quality objectives, setting out factors that would indicate the need for additional quality objectives or developing a framework to assist firms in establishing quality objectives.
  - (b) There were suggestions to be more explicit in the standard that additional quality objectives are not always required and that the required quality objectives are comprehensive. Respondents recommended including the descriptions from the explanatory memorandum about the additional quality objectives in the standard. There were also suggestions to change the requirement to “a consideration” of whether additional quality objectives are necessary to achieve the objective of the standard.
  - (c) There were concerns about the appropriateness of the requirement, as respondents indicated that it could cause difficulties with regulators, who may expect that there are always additional quality objectives or who may impose their own quality objectives on firms.
  - (d) Respondents questioned whether firms would be expected to document that no additional quality objectives have been identified, and if so, how firms should do so.
  - (e) There were some suggestions to give more prominence to the requirement by repeating it in each component. Other respondents suggested bifurcating the requirement into two separate requirements to improve its prominence and clarity.

*Overview of Responses Question 6(c): Do you support the process for the identification and assessment of quality risks?*

71. **Agenda item 4–B.10** summarizes the feedback from respondents on the process for the identification and assessment of quality risks and includes a summary of themes identified from the comments. Overall:
- (a) 29% of respondents supported the process for the identification and assessment of quality risks. 46% of respondents also had this view but had further comments or concerns further explained below.
  - (b) 24% of respondents disagreed with the process for the identification and assessment of quality risks.

Comments from MG Members

72. Two members of the MG commented on the identification and assessment of quality risks, suggesting that the requirements be strengthened to require firms to:
- (a) Consider whether responses need to be designed and implemented for quality risks that have a remote likelihood of occurring, but if they were to occur could have a significant impact. Another respondent from the “regulators and audit oversight authorities” stakeholder group had a similar view.
  - (b) Assess changes in the external environment and a firm’s own business model. Similar comments were made by respondents from the “regulators and audit oversight authorities” stakeholder group.
  - (c) Take findings from regulators into account as part of identifying and assessing quality risks. Another respondent from the “regulators and audit oversight authorities” stakeholder group echoed this comment.
73. It was also suggested by MG members that:
- (a) The standard further emphasize that the process for identifying and assessing quality risks must be dynamic.
  - (b) Guidance be developed to assist firms in identifying and assessing quality risks, since it may be challenging for firms to identify quality risks at the appropriate level of detail.

Comments from Other Respondents

74. Respondents who indicated support for the approach to identifying and assessing quality risks noted that:
- (a) Establishing a threshold in the standard leads to a more consistent approach to risk identification and assessment and allows firms to focus resources on risks that meet the threshold.
  - (b) The required understanding of the conditions, events, circumstances, actions or inactions that may adversely affect the achievement of the quality objectives will facilitate an enhanced understanding of the risks.

75. On the other hand, respondents expressed concern about the threshold for identifying quality risks. Comments included the following:
- (a) Concerns that “more than remote” is too low of a threshold in the context of a firm’s system of quality management, and that it is a different level than “acceptably low level.” There were also suggestions that the threshold in the context of a system of quality management should not be the same as the threshold applied in the ISAs.
  - (b) Concerns that the threshold will result in overly granular and excessive quality risks, burdensome documentation and a disproportionate increase in work effort, possibly to the detriment of quality. It was noted that this is exacerbated by the prescriptiveness of the quality objectives.
  - (c) Concerns that “reasonable possibility” and “more than remote” are terms that are used in the United States Public Company Accounting Oversight Board (PCAOB) standards and are not appropriate in an IAASB Standards’ context.
  - (d) Concerns with describing “reasonable possibility” as equal to “more than remote.” Respondents observed that these two terms do not equate to the same threshold, with respondents perceiving that “more than remote” is a lower threshold than “reasonable possibility.”
76. Various suggestions were also provided by respondents regarding the threshold for the quality risks, including:
- (a) Incorporating the concept of a spectrum of risk, similar to the Changes Made to ED ISA 315, in ED-ISQM 1.
  - (b) Clarifying whether the consideration of the possibility of occurrence and the significance of effect is a joint or separate assessment.
  - (c) Incorporating “more than remote” directly in the requirement.
  - (d) Clarifying the meaning of “significant effect on the achievement of a quality objective(s).” Respondents emphasized that, as currently written, it is subject to varying interpretation and inconsistent application and further highlighted that in the context of the ISAs, the term is grounded in the concept of materiality.
77. Respondents also commented on the following in relation to the process for identifying and assessing quality risks:
- (a) The starting point for quality risks is not clear, i.e., whether firms are expected to consider all potential risks, or only those risks that meet the threshold (it is noted that many of these comments appeared to arise from how the process was articulated in the explanatory memorandum). There were suggestions that the requirement explicitly state that not every quality risk needs to be identified and further assessed.
  - (b) The two-step process of identifying and assessing quality risks is confusing and overengineered, particularly the distinction between (i) a “preliminary consideration” of the likelihood and effect of quality risks; and (ii) a “more detailed consideration” when assessing the quality risks. Respondents provided various suggestions, including condensing the process into a single step.

- (c) The process for identifying and assessing quality risks is overly prescriptive and does not provide flexibility. Respondents therefore suggested being less prescriptive about how the process should be undertaken.
- 78. Respondents commented on the absence of required quality risks in ED-ISQM 1, noting that it is illogical to have quality objectives and responses without quality risks. Respondents provided various suggestions on how this should be addressed, such as removing the required responses and rearticulating the granularity of the quality objectives into quality risks. There were also suggestions to provide examples of quality risks.
- 79. Respondents also commented on the documentation of quality risks. Specifically, respondents sought guidance on how to document the process for the identification and assessment of quality risks, and at what point in the process the documentation needs to begin (e.g., in understanding conditions, events etc.) or only the outcome of the process.
- 80. Respondents commented extensively on the need for guidance to support firms in identifying and assessing quality risks.

*Overview of Responses Question 6(d): Do you support the approach that requires the firm to design and implement responses to address the assessed quality risks? In particular:*

- (a) *Do you believe that this approach will result in a firm designing and implementing responses that are tailored to and appropriately address the assessed quality risks?*
  - (b) *Is it clear that in all circumstances the firm is expected to design and implement responses in addition to those required by the standard?*
81. **Agenda items 4–B.11 and 4-B.12** summarize the feedback from respondents on the responses to quality risks and include a summary of themes identified from the comments. Overall, with respect to the approach for designing and implementing responses:
- (a) 36% of respondents supported the approach and were of the view that it would result in firms designing and implementing responses that are tailored to and appropriately address the assessed quality risks. 50% of respondents also had this view but had further comments or concerns further explained below.
  - (b) 14% of respondents disagreed with the approach or did not think that it would result in firms designing and implementing responses that are tailored to and appropriately address the assessed quality risks.

Overall, with respect to the clarity of the requirement that firms are expected to design and implement responses in addition to those required by the standard:

- (a) 49% of respondents considered that the requirements are clear. 23% of respondents also considered the requirement is clear subject to further comments and suggestions.
- (b) 23% of respondents did not consider the requirement to be clear.

#### Comments from MG Members

- 82. A MG member raised concern that firms may be overly focused on the required responses in the standard. This respondent highlighted that more complex firms and networks will need to do more than the minimum requirements, and also suggested that more emphasis is needed on preventative

required responses. Two other respondents, both from the “regulators and audit oversight authorities” stakeholder group, also suggested that the required responses should be more preventative and proactive.

#### Comments from Other Respondents

83. Consistent with the comments raised in other questions, respondents expressed concern about the prescriptiveness of the required responses, suggesting that it is contrary to a risk-based approach, and emphasized their concerns regarding how SMPs will apply the requirements. Respondents further indicated that:

- (a) It is likely to perpetuate a checklist mentality, rather than promoting a proactive “thinking” approach to managing quality. Respondents also emphasized that firms are less likely to establish additional responses that are needed to address quality risks, and therefore systems will not be appropriately tailored to firms’ circumstances.
- (b) Having required responses in ED-ISQM 1 without having required quality risks is illogical and counter-intuitive. Firms are likely to “backfill” the quality risks to match the responses, resulting in inappropriate risk identification and assessment. Respondents noted that the success of the new risk-based approach is dependent on the firm appropriately identifying and assessing quality risks.
- (c) The inconsistency of the responses across the components is confusing. In particular, respondents highlighted that the lack of responses in some components versus others implies that the components without responses are less important.

While some respondents suggested relocating the responses to application material, others cautioned against doing so, noting that it is likely to have the same effect as having responses in the requirements. Furthermore, one respondent from the “member bodies and other professional organizations” stakeholder group noted that in their extensive outreach activities, they had sought views about whether there are any required responses that are not applicable to all firms, yet participants did not identify any.

84. With respect to the requirement to design and implement responses in addition to those required by the standard, respondents indicated mixed views, including:

- (a) Firms should not in all cases be expected to design and implement responses in addition to those required by the standard, as there may be circumstances when the responses in the standard are sufficient.
- (b) Explicitly stating in the requirement in paragraph 30 of ED-ISQM 1 that additional responses need to be designed and implemented by the firm. There were also suggestions to make the requirement explicit in the individual components.

85. Other suggestions regarding responses included:

- (a) Incorporating the explanation from the explanatory memorandum that “responses to quality risks are analogous to controls” in the standard.
- (b) Further clarifying that a quality objective may be achieved, or quality risk addressed, through more than one response, or that one response may address multiple quality risks.

- (c) Clarifying why required responses are not always included in ED-ISQM 1, so that firms understand why additional responses are always required.
- (d) Developing guidance to support firms in designing and implementing responses, with examples of responses and how to document them.

It was also suggested that by restructuring the components (i.e., placing the firm's risk assessment process first), it will help to clarify that additional responses are needed.

## **C. ISQM 1 TF Proposals on Certain Matters**

86. The explanation of the comments above highlights extensive concerns about the scalability of Proposed ISQM 1 (paragraph 31), including the following key themes:
- (a) There is a need for more clarity that some firms will need to “scale-up” from the standard (paragraph 32).
  - (b) The standard is long and complex and is a hybrid of a risk-based approach and prescriptive requirements (paragraphs 19, 38, 42).
  - (c) The requirements are too prescriptive. This has various potential implications such as (paragraphs 25, 26, 35, 42, 83):
    - (i) Generating the need for smaller firms to “comply or explain” (paragraphs 35, 47).
    - (ii) Creating extensive documentation that will be burdensome for firms (paragraphs 26, 35, 47).
    - (iii) Perpetuating a “checklist mindset”, which is unlikely to drive tailoring (paragraphs 25, 83).
  - (d) Implementing the standard in its current form is likely to be difficult, time consuming, resource intensive and may have a negative impact on quality (paragraphs 26, 41).
  - (e) The standard needs to use a bottom-up approach (paragraph 35).
87. Given the extent of concerns on scalability, the ISQM 1 TF identified this as a key area that needs to be discussed and explored with the Board so that appropriate direction can be obtained in considering further revisions to Proposed ISQM 1. The ISQM 1 TF therefore considered how the scalability of the standard could be addressed, noting that the actions need to be bold to properly address concerns about scalability. The ISQM 1 TF also notes that any actions taken need to accommodate circumstances when firms need to “scale-up” or “scale-down.”
88. As a starting point, the ISQM 1 TF considered:
- (a) How the components and structure of Proposed ISQM 1 can be refined and clarified, in order to simplify the standard and facilitate easier navigation. (see Section C.1 below).
  - (b) Whether the standard should continue to have required quality objectives and responses, and if so, whether the specificity of these requirements remains appropriate (see Section C.2 below).
  - (c) How to simplify and clarify the firm's risk assessment process, and whether the thresholds in the standard remain appropriate (see Section C.3 below).

Although the ISQM 1 TF is of the view that these proposals could go a long way in addressing the scalability concerns, the ISQM 1 TF also believes that consideration is needed about whether Proposed ISQM 1 is an appropriate standard for quality management for all engagements performed under the IAASB's standards (see Section C.4 below).

89. The proposals outlined in the sections below do not include all possible revisions that may be made to the standard to address scalability, i.e., other actions may also be taken, such as further consideration of the drafting and presentation approach used by the ISA 315 Task Force. These will be further explored with the Board as the drafting of the standard is developed.
90. The ISQM 1 TF also notes that given the nature of the proposals outlined below, outreach across all stakeholder groups will be important as the standard is further progressed.

### C.1. The Components and Structure of Proposed ISQM 1

#### **Highlights of Respondents' Comments Summarized in Section B that are Relevant to the Proposals Outlined Below**

- Moving the firm's risk assessment process first may provide better context, improve the readability of the standard and alleviate the need for the introduction (paragraphs 20, 54, 65).
- The firm's risk assessment process and monitoring and remediation process are processes and they should not be addressed or described in the same way as the other components (paragraph 54).
- Information and communication (and resources) are overarching across all the other components, and perhaps should not be separate components (paragraphs 54, 64).
- The firm's risk assessment process should not be applied to monitoring and remediation (paragraph 64).
- Monitoring and remediation has comprehensive requirements; requiring quality objectives and quality risks will cause circularity (paragraph 64).
- Support for the diagrams and other explanations in the Explanatory Memorandum being incorporated in the standard or other support material (paragraph 55).

91. The ISQM 1 TF identified that how the standard addresses the following components needs further consideration:
  - (a) The firm's risk assessment process.
  - (b) Monitoring and remediation process.
  - (c) Information and communication.

While comments were also made on resources, these were isolated and therefore the ISQM 1 TF is of the view that how this component was addressed in ED-ISQM 1 continues to be appropriate.

#### *The Firm's Risk Assessment Process and Monitoring and Remediation Process*

92. The ISQM 1 TF agrees with respondents' views that the firm's risk assessment process and monitoring and remediation process are of a different nature to the other components as these are

processes that are applied to the other components. In particular, the ISQM 1 TF agrees with the comment made by a respondent that these components set out how the system is managed (process), whereas the other components address what needs to be managed (criteria).

93. The ISQM 1 TF therefore debated:

- (a) Whether these components should be described as something other than “components,” in order to better differentiate them from the other components.
- (b) How these components should be treated in the standard in terms of how they interrelate with other components, and with each other.

94. The ISQM 1 TF noted that the COSO Integrated Framework<sup>8</sup> has components similar to the firm’s risk assessment process and monitoring and remediation process, which are described as components in that framework. The ISQM 1 TF is of the view that referring to the firm’s risk assessment process and monitoring and remediation process as “components” in Proposed ISQM 1 does not have any effect, and in any event both of these components are already referred to as “processes” in their titles. Instead, what is important is how these two components are explained and set up in Proposed ISQM 1. As a result, the ISQM 1 TF is of the view that it is not necessary to use terminology other than “components” to describe these two components, i.e., the standard will continue to refer to eight components, rather than six components and two processes.

95. The ISQM 1 TF therefore focused on how the two components are explained and set up in Proposed ISQM 1, including how they interrelate with other components, and with each other. The ISQM 1 TF proposes the following:

- (a) Clarifying in the explanations about the system of quality management (e.g., in the introduction of the standard or the appendix if it is retained) that these components are processes in nature.
- (b) Introducing a requirement in each of these two components that requires the firm to establish a process, so that it is clearer that these are processes in nature. As an example, the requirement could be articulated as follows:

*The examples provided below are illustrative and will require further refinement and consideration.*

The firm shall establish a risk assessment process that enables the firm to establish quality objectives, identify and assess quality risks to the achievement of the quality objectives and design and implement responses to address the assessed quality risks.

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The firm shall establish a monitoring and remediation process that enables the evaluation of the design, implementation and operation of the components of the system of quality management to determine whether the quality objectives have been achieved.

- (c) Moving the firm’s risk assessment process before governance and leadership. This will mean that the risk assessment component is no longer positioned between components of a different nature, which creates confusion about the nature of the firm’s risk assessment process and how it relates to other components (see further discussion below about the ordering of the

<sup>8</sup> Committee of Sponsoring Organizations of the Treadway Commission (COSO), *Internal Control – Integrated Framework*

standard). It is noted that, consistent with the proposals in ED-ISQM 1, the firm's risk assessment process would still be subject to monitoring and remediation.

- (d) Removing the concept that the firm's risk assessment process is applied to the monitoring and remediation process. The ISQM 1 TF observed respondents' concerns about "backfilling" quality objectives and quality risks, given the prescriptive nature of certain components. The ISQM 1 TF notes that the requirements for monitoring and remediation are more prescriptive than other components and therefore the "backfilling" of quality risks is most likely to happen in this component. The ISQM 1 TF considered respondents' comments on monitoring and remediation and is of the view that the prescriptive nature of the requirements in monitoring and remediation remains appropriate.<sup>9</sup> In view of the prescriptive nature of the requirements and the possibility that firms will "backfill," the ISQM 1 TF agrees that requiring firms to establish quality objectives and quality risks is unlikely to provide much benefit; However, the ISQM 1 TF also is of the view that it remains important for firms to take a risk-based approach to the design of its monitoring activities and that firms may need to do more than what the requirements set out in order to achieve the objective of the standard. Accordingly, the ISQM 1 TF recommends:
- (i) Refocusing the requirement in paragraph 44 of ED-ISQM 1 on designing monitoring activities based on risk and addressing the need for the monitoring activities to be sufficient.
  - (ii) Further considering how the evaluation of the system of quality management (paragraphs 55–57 of ED-ISQM 1) may reinforce the concept of the sufficiency of the monitoring activities.

Furthermore, the proposed requirement to establish a process as suggested in (b) above would assist in capturing the concept.

96. In summary, the proposed revisions for the monitoring and remediation process would result in the following broad revisions for this component:

*Refer to Appendix 5 for the paragraphs from ED-ISQM 1*

- Repurposing paragraph 42 of ED-ISQM 1 into a requirement that requires the firm to establish a process, as described above, and removing parts (a)–(c).
- Removing paragraph 43 of ED-ISQM 1.
- Redesigning paragraph 44 of ED-ISQM 1 to focus on designing monitoring activities based on risk and addressing the need for the monitoring activities to be sufficient.
- Retaining the remainder of paragraphs 45–57 of ED-ISQM 1 in their current form (additional changes would be necessary to address respondents' specific comments on these paragraphs).

<sup>9</sup> Monitoring and remediation will be presented to the Board in December 2019. It is the ISQM 1 TF's preliminary view that the monitoring and remediation requirements should remain prescriptive, however will further consider this view, together with further revisions to address respondents' comments, as the ISQM 1 TF prepares its proposals for December 2019.

### Ordering of the Standard

97. As highlighted above, it is proposed that the firm's risk assessment process be moved before governance and leadership to:
- (a) Assist in clarifying how the firm's risk assessment process applies to the other components.
  - (b) Address concerns about the length and complexity of the standard, because it may alleviate the need for the explanations in the introduction of the standard about how the components interrelate. It is noted that the introduction was originally added to address concerns that a reader may not understand the concepts of quality objectives, quality risks and responses in the governance and leadership component because it precedes the firm's risk assessment process.
  - (c) Address comments from respondents that positioning it after governance and leadership is confusing.
98. However, the ISQM 1 TF notes that requiring leadership to be responsible for the system is an essential precondition to establishing a system, and this requirement needs to be more distinct. Furthermore, the ISQM 1 TF observed various comments from respondents on paragraph 20 of ED-ISQM 1 (which deals with leadership's understanding of ED-ISQM 1) that were interrelated with the requirements in paragraph 24(a) of ED-ISQM 1. Accordingly, the ISQM 1 TF suggests relocating the requirements in paragraphs 24(a) and 25 of ED-ISQM 1 (*refer to Appendix 5 for the paragraphs from ED-ISQM 1*) to the initial sections of the standard, to make it clear that these are essential preconditions for establishing a system of quality management. Doing so may also assist in better connecting paragraphs 20 and 24(a) of ED-ISQM 1 and retaining an appropriate focus on leadership responsibilities for the system.
99. Based on these proposals, the new structure of Proposed ISQM 1 would be as follows:

Structure proposed in ED-ISQM 1	Revised structure based on proposals above
Applying, and complying with, relevant requirements	Applying, and complying with, relevant requirements
System of quality management	System of quality management, including paragraphs 24(a) and 25 of ED-ISQM 1 dealing with assigning responsibilities for the system, and other aspects of the system
Governance and leadership, including paragraphs 24(a) and 25 of ED-ISQM 1 dealing with assigning responsibilities for the system, and other aspects of the system	The firm's risk assessment process
The firm's risk assessment process	Governance and leadership
<i>The remaining components would be in the same order:</i>	

Relevant ethical requirements	Relevant ethical requirements
Acceptance and continuance of client relationships and specific engagements	Acceptance and continuance of client relationships and specific engagements
Engagement performance	Engagement performance
Resources	Resources
Information and communication	Information and communication
Monitoring and remediation process	Monitoring and remediation process
Networks	Networks
Service providers	Service providers
Documentation	Documentation

### *Information and Communication*

100. The ISQM 1 TF debated the suggestion that information and communication is overarching across all of the other components and should be incorporated as a consideration in each component. While the ISQM 1 TF agrees that information and communication is pervasive throughout the system, it is of the view that incorporating information and communication into each component, and removing the separate component, is not an appropriate way forward for the following reasons:

- (a) Many of the requirements, particularly paragraphs 40(a) and (b) of ED-ISQM 1, are general in nature and would need to be repeated in each component. The ISQM 1 TF observed numerous comments from respondents about the length of the standard and extent of duplication.
- (b) Removing the component may dilute the importance of information and communication, and without appropriate focus on it, firms may inadvertently overlook what needs to be established to support information and communication. Furthermore, although information and communication is intuitive, it can be easily overlooked.
- (c) Proposed ISQM 1 does not require firms to organize their systems in the same manner as the standard (see paragraph A5 of ED-ISQM 1), and this concept was understood by respondents who indicated support for this approach. As a result, firms may still choose to organize information and communication differently from the standard by incorporating it into the individual components.

Furthermore, the ISQM 1 TF noted that the COSO Integrated Framework has an information and communication component as a separate component.

101. The ISQM 1 TF also debated whether information and communication should be a process, similar to how the firm's risk assessment process and monitoring and remediation process are described above. However, the ISQM 1 TF is of the view that information and communication is a system comprising of multiple processes and is unlike the other two processes that address how the system is managed. Accordingly, the ISQM 1 TF suggests retaining this component largely in its current form, subject to the additional proposals outlined in Section C.2 and further revisions that may be made to address respondents' feedback not included in this paper.

### **Matters for IAASB Consideration**

1. Does the IAASB support reordering the standard, including relocating paragraphs 24(a) and 25, as proposed by the ISQM 1 TF?
2. Does the IAASB support that the firm's risk assessment process and monitoring and remediation processes are "processes"? In particular, does the IAASB agree with:
  - (a) Introducing new overarching requirements for the firm to establish a risk assessment process / monitoring and remediation process?
  - (b) Removing the concept that the firm's risk assessment process is applied to the monitoring and remediation process?
3. Does the IAASB support the conclusion that information and communication should remain a separate component, and that the firm's risk assessment process would continue to apply to information and communication?

### **C.2. How Proposed ISQM 1 Should Address Quality Objectives, Quality Risks and Responses**

#### **Highlights of Respondents' Comments Summarized in Section B that are Relevant to the Proposals Outlined Below**

- Required responses create a perception that it is not a risk-based approach (paragraphs 35, 83).
- Required responses are unlikely to drive tailoring by firms (paragraph 58).
- Lack of required quality risks (in the context of required quality objectives and responses) is illogical (paragraphs 78, 83).
- Required responses in some components and not others imply that some components are more important than others (paragraph 83).
- Suggestions to:
  - Reduce quality objectives and make them more overarching, introduce quality risks or risk factors, and reduce prescriptiveness of responses (paragraph 20, 69).
  - Include required responses that are more preventative and proactive (paragraph 16).
  - Relocate responses to application material or an appendix (paragraph 83).
- MG members seeking:
  - More prescriptive requirements to support inspectability (paragraph 17).
  - More emphasis on preventative responses (paragraph 16, 82).

102. The ISQM 1 TF recognizes the concerns raised by respondents about the lack of scalability of ED-ISQM 1, largely driven by the perceived prescriptiveness of the quality objectives and responses. The ISQM 1 TF is of the view that in order to fully address the scalability concerns (including scaling up), the approach to the quality objectives and responses in the individual components needs to be reconsidered. As a result, the ISQM 1 TF is proposing the following, which is intended to improve the scalability of the standard, but at the same time retain the robustness of the requirements:

- (a) Revise the quality objectives to be higher level, which may result in fewer quality objectives in each component (the detail of the quality objectives would be repurposed into quality risk considerations described below).
- (b) Introduce quality risk considerations that comprise a combination of:
  - (i) The details in the quality objectives that will no longer be retained in the revised quality objectives, as described in part (a); and
  - (ii) Certain responses that were included in the ED, repurposed as quality risk considerations.
- (c) Reduce the required responses, either through:
  - (i) Repurposing the response as a quality risk consideration;
  - (ii) Removing duplication with quality objectives; or
  - (iii) Otherwise removing the response, as appropriate in the context of comments from respondents on the individual components.

An illustration of this approach has been drafted for the “engagement performance” component and is included in the grey box below.

103. Adopting this revised approach would address many issues highlighted in the responses, including:
- (a) The need for firms to “scale up” and be proactive in managing quality, since firms would more clearly need to design and implement their own responses. This approach may also address comments about the need for preventative responses, which is linked to the proactivity of the firm.
  - (b) Misconceptions about whether, or the extent to which, firms should design and implement their own responses, or the extent to which the required responses themselves should be tailored. It would also reduce the perception that some components are more important than others because of the number of required responses.
  - (c) Concerns that ED-ISQM 1 did not integrate the risk-based approach because there are no quality risks in the components. It also may reduce the possibility that firms merely “backfill” quality risks.
  - (d) Ensuring there is a certain level of consistency across firms. The ISQM 1 TF noted various concerns regarding a lack of consistency in interpretation and application, however the ISQM 1 TF is of the opinion that firms need to tailor their systems in order to appropriately address quality (there is no “one size fits all”). While this revised approach would not prescribe everything a firm would need, it would address expected considerations so that there is an appropriate level of commonality across firms.
104. In developing the quality risk considerations, the ISQM 1 TF considered:
- (a) The approach adopted in Appendix 3 of ISA 315 (Revised),<sup>10</sup> which instead of listing the actual risks, provides a list of conditions or events that could indicate a risk of material misstatement.

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<sup>10</sup> ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

- (b) Whether risk factors, similar to the inherent risk factors in the Changes Made to ED-315 would be appropriate. However, the ISQM 1 TF could not identify risk factors that would be common to the components, and noted that risk factors would unlikely be prescriptive enough to retain the robustness of ED-ISQM 1.
  - (c) How the quality risk considerations would need to be articulated. The ISQM 1 TF agreed that these should not be phrased “in the negative” so as not to appear to be prescribed quality risks. Furthermore, the ISQM 1 TF noted the importance of ensuring that it is clear that the quality risk considerations are not exhaustive.
105. The ISQM 1 TF is considering which responses should remain as required responses in Proposed ISQM 1 under the revised approach. As highlighted previously in this paper, the ISQM 1 TF is of the view that the required responses in the monitoring and remediation component of ED-ISQM 1 would be retained as requirements, although may be revised to address respondents’ specific feedback.

**Illustration of how the revised approach for the quality objectives, quality risk considerations and responses would be applied to the engagement performance component**

*This has been provided for illustrative purposes for the Board. The ISQM 1 TF is not seeking input on the specifics of the requirements illustrated below in the plenary session and is only seeking general direction on the revised approach. Board members are welcome to provide editorial comments offline on the proposals below.*

*Refer to Appendix 5 for paragraphs 36–37 of ED-ISQM 1, for comparison with the proposals below*

Quality objectives

36. The firm shall establish the following quality objectives that address the performance of quality engagements:
- (a) The firm takes actions that promote and support:
    - (i) The consistent performance of quality engagements in accordance with professional standards and legal and regulatory requirements.
    - (ii) Engagement teams in understanding and fulfilling their responsibilities in connection with the engagement, including exercising appropriate professional judgment and professional skepticism such that conclusions reached are appropriate.
  - (b) The firm manages the assembly, maintenance and retention of engagement documentation.

Quality risk considerations

- 36A. The firm shall identify and assess quality risks, and in doing so shall take into account, as a minimum, the following quality risk considerations:
- (a) The competence and capabilities of individuals assigned to:
    - (i) Plan and perform engagements, and direct and supervise the engagement team or review work performed; and

- (ii) Provide consultation on difficult or contentious matters or resolve differences of opinion.
- (b) The sufficiency and clarity of the engagement team's responsibility for:
  - (i) Planning and performing engagements in accordance with professional standards and applicable legal and regulatory requirements;
  - (ii) Undertaking appropriate direction and supervision of engagement teams and review of work performed by less experienced members of the engagement team.
  - (iii) Undertaking consultation on difficult or contentious matters and implementing the conclusions reached.
  - (iv) Bringing differences of opinion to the attention of the firm so that they can be objectively resolved.
  - (v) Assembling engagement files within an appropriate period of time after the engagement reports have been finalized.
- (c) The sufficiency and clarity of the engagement partner's responsibility for:
  - (i) Managing and achieving quality on the engagement and for being sufficiently and appropriately involved throughout the engagement.
  - (ii) The appropriate direction and supervision of the engagement team and review of the work performed.
- (d) The resources for the retention and maintenance of engagement documentation to meet the needs of the firm and comply with law, regulation, relevant ethical requirements, or other professional standards.

#### Responses

37. The firm shall design and implement responses to address the quality risks identified and assessed by the firm, which shall include the following responses:

*[Note the response below is being considered by the ISQM 2 TF]*

- (a) Establishing policies or procedures addressing engagement quality reviews that are designed and implemented in accordance with ISQM 2, and that require an engagement quality review for:
  - (i) Audits of financial statements of listed entities;
  - (ii) Audits of financial statements of entities that the firm determines are of significant public interest; and
  - (iii) Audits or other engagements for which:
    - a. An engagement quality review is required by law or regulation; or

- b. The firm determines that an engagement quality review is an appropriate response to assessed quality risks, based on the reasons for the assessments given to those risks.

#### **Matters for IAASB Consideration**

4. Does the IAASB support the proposals to revise the approach to required quality objectives, quality risks and responses in the components by:
- (a) Revising the quality objectives to be higher level, which may result in fewer quality objectives;
  - (b) Introducing quality risk considerations; and
  - (c) Reducing the required responses?

### **C.3. How the Standard Addresses the Firm's Risk Assessment Process**

#### **Highlights of Respondents' Comments Summarized in Section B that are Relevant to the Proposals Outlined Below**

- The firm's risk assessment process is prescriptive, complex and challenging to implement, particularly the requirements to identify and assess quality risks (paragraphs 35, 58).
- The two-step process of identifying and assessing quality risks is prescriptive, confusing and overengineered (paragraph 77).
- The threshold at which quality risks need to be identified is too low, and concerns with the terminology used. However, MG members seeking requirements for firms to consider quality risks that are remote and have a significant effect on the achievement of a quality objective (paragraphs 72, 75).
- Clarify the meaning of "significant effect on the achievement of a quality objective" (paragraph 76).
- Clarify circumstances when firms need to establish additional quality objectives and be more explicit that additional quality objectives are not always required. Explore whether the standard should only require "a consideration" by the firm of whether additional quality objectives are needed (paragraphs 67, 70).
- Clarify expectations regarding designing and implementing responses in addition to those required by the standard (paragraphs 84, 85).

#### *Matters of Relevance from the Changes Made to ED-315*

106. The ISQM 1 TF noted the current status of key aspects of the Changes Made to ED-315, including key decisions made in response to the comments on that ED, in particular:
- (a) The decision to remove "more than remote."
  - (b) How "reasonable possibility" has been used in the Changes Made to ED-315, including the connection with "could" and "acceptably low level."

- (c) The Changes Made to ED-315 continue to separate the identification and assessment of risks of material misstatement into two discrete requirements.
  - (d) The decision to develop implementation materials that provide a roadmap and explanation of how the requirements to identify and assess risks of material misstatement are intended to operate.
107. The ISQM 1 TF considered whether there is a need for Proposed ISQM 1 to mirror the approach and concepts of the Changes Made to ED-315. Given that the concept of financial statement materiality does not apply to Proposed ISQM 1, and the nature of risks and purpose for which they will be used are different from the Proposed Changes Made to ED-315, the ISQM 1 TF suggests that there is not a need for Proposed ISQM 1 to strictly follow the same approach as the Changes Made to ED-315.
108. The ISQM 1 TF notes that the proposals outlined below are consistent with the concepts and principles in the Changes Made to ED-315, however the structure of the proposals is different. The ISQM 1 TF will continue to monitor the work of the ISA 315 Task Force and how this affects the concepts and principles in Proposed ISQM 1.

*Proposals for Proposed ISQM 1*

109. The ISQM 1 TF is of the view that addressing the complexity of the firm's risk assessment process and the threshold for the quality risks will significantly alleviate respondents' concerns about the scalability of the standard.
110. In relation to the complexity of the firm's risk assessment process, the ISQM 1 TF proposes the following, which is illustrated in the grey block at the end of this section:
- (a) Condensing the two-step process into a single requirement to identify and assess quality risks, in order to simplify the approach and minimize concerns about duplicative effort embedded within the two steps. The ISQM 1 TF is of the view that in some cases it is appropriate to undertake the quality risk identification and assessment as discrete steps, however as this is not always the case and to better support a bottom-up approach, this should be acknowledged in application material (rather than being required).
  - (b) Refocusing the requirements away from being process-driven, to outcome-based (i.e., the identification and assessment of quality risks to provide a basis for the design and implementation of responses). The ISQM 1 TF referred to paragraphs 25–26 of extant ISA 315 (Revised) in structuring the requirement in this manner.
111. In relation to the threshold of the quality risks, the ISQM 1 TF is of the view that (see also the illustration the grey block at the end of this section):
- (a) The proposal to include "quality risk considerations" in each component will drive consistency in risk identification, and this is emphasized through referencing to the quality risk considerations as part of the requirement to identify and assess quality risks. The inclusion of a quality risk threshold in ED-ISQM 1 was to support consistent risk identification across firms. Accordingly, by introducing quality risk considerations, there is a reduced need for a quality risk threshold.
  - (b) The requirement to identify and assess quality risks can be further simplified and clarified by relocating the quality risk threshold. In order to support firms in identifying and assessing quality risks, the ISQM 1 TF proposes:

- (i) Amending the definition of a quality risk to better reflect that it is a risk that “could, individually or in combination with other quality risks” adversely affect the achievement of a quality objective.
- (ii) Adding application material that provides guidance about what “could” means to assist firms in determining what quality risks may need to be identified and assessed (see further discussion in paragraph 112 below). The ISQM 1 TF also suggests that this material explain how the risk tolerance level is linked to the public interest.
- (iii) Introducing application material, similar to the Changes Made to ED-315, that explains the concept of spectrum of risk.

112. However, the ISQM 1 TF had varying views about how the application material should describe what “could” means in the context of likelihood, and whether it should continue to refer to “reasonable possibility.” While the TF unanimously agreed that “more than remote” should be removed from the standard, there were varying views about:

- (a) Retaining “reasonably possible” with concerns that, in the context of Proposed ISQM 1, “reasonable possibility” could be interpreted as a high threshold and therefore firms may not identify certain risks that should be identified, assessed and responded to.
- (b) Whether another term should be identified, such as “reasonably be expected to occur.”

The ISQM 1 TF also discussed the concept of acceptably low level as the threshold. The ISQM 1 TF noted that “acceptably low level” reflects the combination of likelihood and magnitude and does not address the threshold for likelihood, which is the purpose for which “reasonably possible” was used in ED-ISQM 1.

113. With respect to the magnitude of effect, i.e., the effect on achievement of a quality objective, the ISQM 1 TF suggests:

- (a) That it is no longer appropriate to describe the magnitude of effect as “a significant effect on the achievement of a quality objective.” This is largely because the quality objectives required by the standard will be fewer and more high-level, as proposed in Section C.2. Therefore, if a matter has a significant effect on the achievement of a quality objective, it would likely be so significant that it would result in the firm not achieving reasonable assurance overall, and this threshold is too high for purposes of risk identification.
- (b) Referring directly to “could adversely affect the achievement of a quality objective” (see the proposed revision to the definition of quality risk in the grey block at the end of this section).
- (c) Being clear that the consideration of the effect of a quality risk is on the quality objectives in the standard, or additional quality objectives identified by the firm. The ISQM TF observed that identifying quality risks in relation to more granular quality objectives established by the firm may inadvertently lower the risk threshold.

114. The ISQM 1 TF also considered respondents views about the need to clarify the circumstances when firms need to establish additional quality objectives, and overall concerns about the expectations of this requirement. The ISQM 1 TF observed that circumstances when firms may need to establish additional quality objectives is not expected to be common practice, i.e., the standard is set up for more unusual circumstances or for future conditions that may arise for which quality objectives will

be needed. As a result, the ISQM 1 TF recommends that a bottom-up approach be adopted for this requirement through adjusting the requirement to a “consideration.”

115. With respect to the requirements addressing responses, the ISQM 1 TF observed that reducing the required responses (see Section C.2) will assist in clarifying that in all cases firms are expected to design and implement responses in addition to those required by the standard. However, the ISQM 1 TF also proposes clarifying this point in the requirement to design and implement responses, as suggested in the grey block below.

**Illustration of how the proposals above would affect the requirements for the firm’s risk assessment process**

*This has been provided for illustrative purposes for the Board. The ISQM 1 TF is not seeking input on the specifics of the requirements illustrated below in the plenary session and is only seeking general direction on the revised approach. Board members are welcome to provide comments offline on the proposals below.*

**Definitions**

19. In this ISQM, the following terms have the meanings attributed below:

- (p) Quality objectives – The objectives required by this ISQM and additional quality objectives established by the firm that, when achieved by the firm, collectively provide the firm with reasonable assurance that the objectives of the system of quality management are achieved.
- (q) Quality risks – Risks arising from conditions, events, circumstances, actions or inactions that could may, individually or in combination with other quality risks, adversely affect the achievement of a quality objective(s).

**Requirements**

26. The firm shall establish ~~the~~ quality objectives to achieve the objective of ~~required by this ISQM.~~ For this purpose ~~the firm shall:~~

- (a) Establish the quality objectives required by this ISQM.
- (b) Also consider whether ~~establish~~ additional quality objectives beyond those required by this ISQM, ~~when those objectives~~ are necessary to achieve the objective of this ISQM.

27. ~~—~~ [Moved to paragraph 28(a)]

28. ~~Based on the understanding obtained in paragraph 27, the~~ firm shall identify and assess ~~these~~ quality risks to provide a basis for the design and implementation of responses. ~~before consideration of any responses, that:~~ For this purpose, the firm shall:

- (a) ~~[Moved from paragraph 27]~~ The firm shall ~~u~~Understand the conditions, events, circumstances, actions or inactions that may adversely affect the achievement of ~~the~~ its quality objectives, taking into account the quality risk considerations identified in this ISQM and the nature and circumstances of the firm and its engagements, ~~to provide the basis for the identification and assessment of quality risks.; and~~

- (b) Consider the likelihood of the quality risks occurring, and if they were to occur the effect on the achievement of a quality objective(s) before consideration of any response.
- (a) ~~Have a reasonable possibility of occurring; and~~
- (b) ~~If they were to occur, may individually or in combination with other quality risks, have a significant effect on the achievement of a quality objective(s).~~
29. ~~The firm shall assess the quality risks identified in paragraph 28 to provide a basis for the design and implementation of the related responses.~~
30. The firm shall design and implement responses to address the assessed quality risks, including the responses required by this ISQM. For this purpose the firm shall:
- (a) ~~The d~~Design of the responses in a manner that is ~~shall be~~ based on, and responsive to, the reasons for the assessments given to the quality risks.
- (b) Include the responses required by this ISQM as part of the responses designed and implemented by the firm.

*[Note that the ISQM 1 TF has not further considered comments related to paragraph 31 of ED-ISQM 1, which deals with the impact of changes in the nature and circumstances of the firm on the quality objectives, quality risks or responses. Given the relationship of this requirements with certain aspects of monitoring and remediation, the ISQM 1 TF will consider the comments on this requirement in conjunction with the comments on monitoring and remediation in December 2019.]*

#### **Matters for IAASB Consideration**

5. The IAASB is asked to provide their views on the proposals addressing the requirements for the identification and assessment of quality risks, including whether:
  - (a) The IAASB supports simplifying the requirements, including condensing the two-step process and addressing the quality risk threshold through the definition of “quality risks” and application material?
  - (b) Proposed ISQM 1 should retain the concept of “reasonable possibility” in the context of likelihood, or whether another term should be used?
6. Does the IAASB agree with the suggestion to adjust the requirement to establish additional quality objectives to a “consideration”?

#### **C.4. The Scope of Firms and Services Covered by Proposed ISQM 1**

##### **Highlights of Respondents’ Comments Summarized in Section B that are Relevant to the Proposals Outlined Below**

- The extent of public interest associated with engagements performed under the IAASB standards varies widely (paragraph 36).
- ED-ISQM 1 is audit focused. The reasons for revising the standard were driven by the issues highlighted in the ITC, which were mostly audit-related (paragraph 36).

- Firms that only perform related services engagements may struggle to apply a risk-based approach, given that a risk approach is not applied in related services engagements. Accordingly, a risk-based approach may be excessive and burdensome for certain firms (paragraph 36).
- Suggestions to develop a separate standard or separate requirements to address quality management of non-audit engagements or audits of less complex entities, or freezing ISQC 1 that it continues to apply to quality management for these engagements (paragraph 36).

116. ED-ISQM 1, as with extant ISQC 1, applies to firms that perform audits and reviews of financial statements and other assurance and related services engagements. The ISQM 1 TF is aware that there are certain jurisdictions where ISQC 1 is not applicable to related services engagements, or only certain requirements of the standard are applicable, including Canada, Australia and New Zealand.
117. The ISQM 1 TF agrees with the views of respondents that many of the revisions to ED-ISQM 1 were to address issues in the ITC stemming from audit engagements and therefore aspects of the standard may appear audit-focused. The ISQM 1 TF notes that all assurance engagements have a fundamental principle that is similar in nature: they provide an opinion or conclusion designed to enhance the degree of confidence of intended users. Accordingly, the ISQM 1 TF is of the view that the approach to managing quality for audits, reviews and other assurance engagements should be substantially similar given the public interest of these engagements. However, the ISQM 1 TF agrees that firm-level quality management for related services engagements is much simpler because of the extent of public interest of related services engagements and the nature of the engagements.
118. The ISQM 1 TF recognizes respondents' concerns about the prescriptiveness of the standard, and that this may create a "comply or explain" approach and a documentation burden, particularly firms for whom certain requirements are not relevant. While the ISQM 1 TF has proposed revisions to how quality objectives, quality risks and responses are addressed in the standard (see Section C.2), the ISQM 1 TF notes that there will be a level of specificity in the standard to drive consistency. Given the need to drive consistent quality management of audit and assurance engagements, certain requirements may not be relevant or necessary to managing quality of related services engagements (e.g., independence, undertaking performance evaluations of firm leadership or communications with external stakeholders about the firm's system of quality management). Therefore, despite the proposals in Section C.2 to improve the scalability of Proposed ISQM 1, there are likely to be requirements that may not be relevant, or necessary, in managing quality of related service engagements.
119. In addition to certain requirements not being relevant or necessary, the ISQM 1 TF observed respondents' concerns that firms performing related service engagements may struggle to apply a risk-based approach. The ISQM 1 TF is therefore concerned that the risk-based approach may cause an increase in work effort for firms in managing the quality of related services engagements that is disproportionate to the possible improvements to engagement quality.
120. The ISQM 1 TF is therefore of the view that it would be in the public interest to have separate requirements for quality management of audit and assurance engagements and quality management of related services engagements. Taking such an approach would:
- (a) Assist in addressing the scalability concerns outlined in Section B, particularly the relevance of certain requirements to quality management of related services engagements.

- (b) Facilitate better focus on quality management of assurance engagements in Proposed ISQM 1, which will help to improve the robustness and clarity of Proposed ISQM 1.
- (c) Have similarities to the approach adopted in the IESBA Code, which contains certain sections that are applicable only to professional accountants performing audits, reviews and other assurance engagements.

*Applicability of the Proposed Separate Requirements: Firms Performing Related Services Engagements versus Managing Quality of Related Services Engagements*

121. The ISQM 1 TF debated whether the separate requirements should apply to:

- (a) Firms that only perform related services engagements (i.e., firms that perform audits, reviews and other assurance engagements would apply Proposed ISQM 1 in managing the quality of all engagements, including related services engagements); or
- (b) A firm's management of the quality of related services engagements (i.e., the requirements apply to managing the quality of related services engagements and if a firm also performs audits, reviews and other assurance engagements, Proposed ISQM 1 applies to managing the quality of audits, reviews and other assurance engagements).

122. The ISQM 1 TF is of the view that option (b) is more appropriate because the management of quality should be consistent for engagements, irrespective of the nature of the firm or diversity of engagements a firm performs. Option (b) would therefore create a minimum expectation of how firms should manage quality of related service engagements. As a result, firms who perform a variety of engagements would have flexibility in determining how best to manage quality of their related services engagements in their circumstances. For example, firms could choose to either:

- (a) Apply:
  - (i) Proposed ISQM 1 to the management of quality for audits, reviews and other assurance engagements, and
  - (ii) The requirements for related services to the management of quality for related services engagements.

or

- (b) Apply Proposed ISQM 1 to the management of quality for all engagements the firm performs.

*Location of the Requirements for Firm-Level Quality Management Over Related Services Engagements*

123. The ISQM 1 TF debated where the requirements for firm-level quality management over related services engagements should be contained and identified three possible options:

- (a) Develop a separate ISQM standard for related services engagements ("ISQM 3" for ease of reference). The standard would unlikely have a risk-assessment process similar to Proposed ISQM 1 and would be more similar in drafting style to extant ISQC 1. Nevertheless, the standard would likely contain specific aspects of Proposed ISQM 1 (e.g., governance and leadership) to cater for necessary improvements in quality management.

- (b) Incorporate the firm-level quality management requirements directly into ISRS 4400<sup>11</sup> and ISRS 4410 (Revised).<sup>12</sup> The requirements would be similar to those described in (a) above, with the key difference being that they are located directly in ISRS 4400 and ISRS 4410 (Revised).
  - (c) Include discrete requirements in Proposed ISQM 1 for firms performing related services engagements.
124. The ISQM 1 TF is of the view that a separate standard is most appropriate, as it will result in less repetition across the related services standards and more clearly separates the responsibility of the firm and engagement team. The ISQM 1 TF is not in favor of including discrete requirements in Proposed ISQM 1 since doing so may:
- (a) Increase the length of Proposed ISQM 1 further and continue to cause concern that the standard is not scalable, due to a lack of visibility of such requirements.
  - (b) Cause confusion about which parts of the standard are relevant to which firms or engagements.
- Furthermore, the ISQM 1 TF notes that the references to professional skepticism in ED-ISQM 1 were conditional because it is not a concept that is relevant to related services engagements and developing a separate standard would address respondents concerns that the conditionality was confusing.
125. The ISQM 1 TF notes that, consistent with current practice, certain jurisdictions may not mandate the application of Proposed ISQM 1 to quality management for related service engagements. The ISQM 1 TF is of the view that establishing a separate standard may encourage jurisdictions who do not require extant ISQC 1 to be applied to quality control for related services engagements to adopt ISQM 3, as it would be a more relevant and tailored standard. The ISQM 1 TF also notes that some jurisdictions may prefer that Proposed ISQM 1 be relevant to quality management of all engagements, in which case those jurisdictions could choose to mandate the application of Proposed ISQM 1 in their jurisdiction.

#### *Other Considerations*

126. Other considerations in determining whether proposed “ISQM 3” is an appropriate way forward include the following:
- (a) It is unlikely that a separate standard (or requirements in ISRS 4400 and 4410 (Revised)) will be ready for approval by the time Proposed ISQM 1 is approved. As a result, the ISQM 1 TF proposes that extant ISQC 1 remain effective for firm-level quality management over related services engagements until such time as the new standard becomes effective.
  - (b) The development of a separate standard (or requirements in ISRS 4400 and 4410 (Revised)) would need to be managed by a Task Force separate from the ISQM 1 TF, so that the progression of a separate standard does not compromise the timely progress of Proposed ISQM 1. Consideration would be needed about when the project could be initiated, in the context of the [Proposed Strategy for 2020–2023 and Work Plan for 2020–2021](#).

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<sup>11</sup> International Standard on Related Services (ISRS) 4400, *Engagements to Perform Agreed-upon Procedures Regarding Financial Information*

<sup>12</sup> ISRS 4410 (Revised), *Compilation Engagements*

- (c) The proposal is a significant change in approach, and further input from respondents may be appropriate before proceeding to develop a separate standard. Accordingly, the ISQM 1 TF proposes that a short survey be issued by the IAASB in Quarter 4 of 2019 to solicit stakeholder input to determine whether there is evidence to support a revised approach. Such a survey could include the elements outlined below and would be open for feedback for approximately 30 days.

#### **Outline of Proposed Survey**

*[This outline has been provided for illustrative purposes. Board feedback is not being sought on the specific content of the survey.]*

- Background information:
  - Highlights of respondent feedback.
  - Emphasis that other actions are being considered to address scalability concerns.
  - Proposal to develop separate requirements for firm-level quality management over related services engagements, describing the three possible ways that this can be achieved, with the related benefits and drawbacks.
  - Proposed applicability of the separate requirements for firm-level quality management over related services engagements, i.e., it applies to firms as it relates to their management of quality for related services engagements. Example of applicability to firm who only performs related services engagements, versus a firm who performs a variety of engagements.
- Questions:
  - Should separate requirements be developed for firm-level quality management over related services engagements?
  - If separate requirements should be developed for firm-level quality management for related services engagements, should these be included in:
    - A separate quality management standard (e.g., ISQM 3)?
    - ISQM 1 as separate requirements?
    - The related services standards themselves, i.e., in ISRS 4400 and ISRS 4410 (Revised)?
  - Additional comments.
  - Request for information of organization name, stakeholder group and region.

#### *Previous Discussions with the IAASB*

127. In September 2016,<sup>13</sup> the Board discussed the option of developing separate standards for quality management, based on the types of engagements performed by firms. At the time, the proposal suggested that firms performing audits of listed entities be subject to a more rigorous quality

<sup>13</sup> Refer to [Agenda Item 5-A](#) of the September 2016 IAASB meeting, and the related [minutes](#).

management standard than firms performing audits of non-listed entities and assurance engagements. The proposals also indicated that the applicable standard (termed “ISQC 1, 2 and 3” at the time) would be driven by the types of services performed by the firm, i.e., if a firm performed audits of listed entities the most rigorous ISQC would apply to quality management of all engagements the firm performs.<sup>14</sup>

128. At the time, the Board suggested that the development of three standards be deferred, so that efforts could be focused on developing the new QMA. However, concerns raised by the Board about the proposal included the difficulties of defining the “boundaries” between the different standards, creating perceptions that firms have different levels of quality, and difficulties in creating consistency across networks.
129. The ISQM 1 TF is of the view that the proposal outlined above is significantly different from the September 2016 proposal, and overcomes the challenges outlined by the Board in response to that proposal. This is because:
- (a) Different levels of quality would not arise between firms, because the proposed standard would apply to firms in the context of how they manage quality of related service engagements. The same principle would apply to networks.
  - (b) The boundaries proposed above are simpler than what had been outlined in September 2016, thereby reducing the complexity of the proposal.

#### *Coordination with Other Task Forces*

130. Given the significance of these proposals to ISRS 4400 and ISRS 4410 (Revised), the proposals outlined above were discussed with the Agreed-Upon-Procedures (AUP) TF. The AUP TF was not presented with the other proposals outlined in Section C.1–C.3 of this paper, and their feedback was focused solely on the proposal in Section C.4. A number of matters were raised by the AUP TF during the discussion for consideration by the ISQM 1 TF, including:
- (a) The need for a full understanding of the issues that are specific to related services engagements as this will be critical to determining what are the appropriate options to address the issues. Further input may need to be obtained from stakeholders in this respect.
  - (b) If the other solutions to address scalability concerns proposed by the ISQM 1 TF can make the standard truly risk-based, this may also help address issues with Proposed ISQM 1 that are specific to related services engagements.
  - (c) Understanding the different circumstances in which AUP and compilation engagements are conducted in different jurisdictions, which may be important in determining an appropriate solution.
131. The ISQM 1 TF has also shared these proposals with the ISQM 2 TF Chair. If the Board supports the proposals to develop separate requirements for firm-level quality management over related services engagements, further consideration will be needed of how ISQM 3 should address the scope of

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<sup>14</sup> Agenda Item 5-A of the September 2016 meeting indicated that “The decision as to which quality control standard would apply to a particular firm would then be based on the types of engagements the firm undertakes overall, rather than on an engagement by engagement basis, with the decision based on the ‘highest’ level of assurance engagement being performed by a firm.”

engagements subject to engagement quality reviews, in order to create the appropriate linkages with ED-ISQM 2.

**Matters for IAASB Consideration**

7. Does the IAASB agree that there is a need to develop separate requirements for firm-level quality management over related service engagements? If so:
  - (a) Does the IAASB agree that the requirements apply to firms as it relates to their management of quality for related services engagements?
  - (b) Should the separate requirements be included in:
    - (i) A separate quality management standard (e.g., ISQM 3)?
    - (ii) Proposed ISQM 1 as separate requirements?
    - (iii) The related services standards themselves, i.e., in ISRS 4400 and ISRS 4410 (Revised)?
8. Does the IAASB support issuing a survey to obtain stakeholder input on the proposed way forward?
9. Are there other issues arising from the comments on the questions summarized in Section B of this paper (i.e., question 1 and related subquestions, question 2, question 4, and question 6 and related subquestions) that should be considered by the ISQM 1 TF?

## Appendix 1

### **ISQM 1 TF Activities Including Outreach and Coordination with Other IAASB Task Forces and Working Groups**

1. The following sets out the activities of the ISQM 1 TF including outreach with others and coordination with other IAASB Task Forces and Working Groups relating to the [quality management project](#).

#### **Task Force Activities in Quarter 3 of 2019**

2. In the 3<sup>rd</sup> quarter of 2019, the ISQM 1 TF has met once in person and held two teleconferences.

#### **Coordination with Other IAASB Task Forces and Working Groups and Other Standard Setting Boards**

##### *ISA 220 TF, ISQM 2 TF and ISA 600 TF*

3. In the 3<sup>rd</sup> quarter of 2019, the Chairs of the four Task Forces and staff held two teleconferences. Further coordination has also been facilitated through staff liaison.

##### *AUP TF*

4. In the 3<sup>rd</sup> quarter of 2019, the Chairs of the two Task Forces and staff held one teleconference. Furthermore, the AUP TF held a special teleconference to discuss the ISQM 1 TF proposals related to the applicability of Proposed ISQM 1 to related services engagements, in which Staff supporting ISQM 1 participated.

##### *IESBA*

5. The feedback from respondents on Question 8 of ED-ISQM 1 was shared with IESBA Staff, as well as other ad-hoc comments received from respondents related to coordination matters with IESBA. Further coordination on these matters is planned to be undertaken in the 4<sup>th</sup> quarter of 2019.

## Appendix 2

### List of Respondents to ED-ISQM 1

	Respondent	Region
<b>Monitoring Group</b>		<b>Total: 4</b>
1	Basel Committee on Banking Supervision	Global
2	International Association of Insurance Supervisors	Global
3	International Forum of Independent Audit Regulators	Global
4	International Organization of Securities Commissions	Global
<b>Investors and Analysts</b>		<b>Total: 2</b>
5	Corporate Reporting Users' Forum	Global
6	International Corporate Governance Network	Global
<b>Regulators and Audit Oversight Authorities</b>		<b>Total: 4</b>
7	Canadian Public Accountability Board	North America
8	Financial Reporting Council United Kingdom	Europe
9	Independent Regulatory Board for Auditors	Middle East and Africa
10	Irish Auditing and Accounting Supervisory Authority	Europe
<b>National Auditing Standard Setters</b>		<b>Total: 14</b>
11	AICPA	North America
12	Australian Auditing and Assurance Standards Board	Asia Pacific
13	Canadian Auditing and Assurance Standards Board	North America
14	Chinese Institute of Certified Public Accountants	Asia Pacific
15	Compagnie Nationale des Commissaires aux Comptes and the Conseil Supérieur de l'Ordre des Experts-Comptables	Europe
16	Conselho Federal de Contabilidade - Federal Accounting Council	South America
17	Hong Kong Institute of Certified Public Accountants	Asia Pacific
18	Institut Der Wirtschaftsprüfer	Europe
19	Japanese Institute of CPAs	Asia Pacific
20	Kammer der Steuerberater und Wirtschaftsprüfer	Europe
21	Malaysian Institute of Accountants - Auditing and Assurance Standards Board	Asia Pacific
22	New Zealand Auditing and Assurance Standards Board	Asia Pacific
23	Royal Nederlandse Beroepsorganisatie van Accountants	Europe
24	Saudi Organization for CPAs	Middle East and Africa
<b>Accounting Firms</b>		<b>Total: 25</b>
25	Baker Tilly International	Global

	Respondent	Region
26	Baker Tilly Virchow Krause LLP	North America
27	BDO International	Global
28	CAS International	Asia Pacific
29	Crowe Global	Global
30	Deloitte Touche Tohmatsu Limited	Global
31	Duncan and Topliss	Europe
32	ETY Global	Middle East and Africa
33	EY Global Limited	Global
34	Grant Thornton International Limited	Global
35	Haysmacintyre LLP	Europe
36	KPMG IFRG Limited	Global
37	Kreston International	Global
38	Mazars	Global
39	Mazars USA LLP	North America
40	MGI Worldwide	Global
41	MNP LLP	North America
42	Moore Stephens International	Global
43	Nexia International	Global
44	Nexia Smith & Williamson	Europe
45	PKF International Limited	Global
46	PKF South Africa	Middle East and Africa
47	PriceWaterhouseCoopers	Global
48	RSM	Global
49	SRA	Europe
<b>Public Sector Organizations</b>		<b>Total: 10</b>
50	Auditor General South Africa	Middle East and Africa
51	Australasian Council of Auditors General	Asia Pacific
52	International Organization of Supreme Audit Institutions	Global
53	National Audit Office of Malta	Europe
54	Office of the Auditor General New Zealand	Asia Pacific
55	Office of the Auditor General of Alberta	North America
56	Office of the Auditor General of Canada	North America
57	Provincial Auditor Saskatchewan	North America
58	Swedish National Audit Office	Europe

	Respondent	Region
59	US Government Accountability Office	North America
<b>Member Bodies and Other Professional Organizations</b>		<b>Total: 37</b>
60	Accountancy Europe	Europe
61	Australian Accounting Professional and Ethics Standards Board	Asia Pacific
62	Belgian Institute of Registered Auditors	Europe
63	CA Ireland	Europe
64	California Society of CPA's	North America
65	Center for Audit Quality	North America
66	Chartered Accountants Australian and New Zealand and ACCA	Global
67	Comision Interamericana de Control de Calidad de la AIC	South America
68	Comite Control de Calidad del ICPARD	South America
69	Consiglio Nazionale dei Dottori Commercialisti e degli Esperti Contabili	Europe
70	CPA Australia	Asia Pacific
71	European Federation of Accountants and Auditors for SMEs	Europe
72	EXPERTsuisse	Europe
73	FAR (Institute for Accounting Profession in Sweden)	Europe
74	FSR - Danish Auditors	Europe
75	IFAC Small and Medium Practices Committee	Global
76	Illinois CPA Society	North America
77	Institut des Experts-Comptables et des Conseils Fiscaux – Instituut Van de Accountants en de Belastingconsulenten	Europe
78	Institute of Chartered Accountants in England and Wales	Europe
79	Institute of Chartered Accountants of Pakistan	Asia Pacific
80	Institute of Chartered Accountants of Scotland	Europe
81	Institute of Chartered Accountants of Sri Lanka	Asia Pacific
82	Institute of CPAs of Uganda	Middle East and Africa
83	Institute of Independent Auditors of Brazil	South America
84	Institute of Singapore Chartered Accountants	Asia Pacific
85	Instituto de Censores Jurados de Cuentas de España	Europe
86	Instituto Mexicano de Contadores Públicos	North America
87	Korean Institute of CPAs	Asia Pacific
88	Malaysian Institute of CPAs	Asia Pacific
89	National Association of State Boards of Accountancy	North America
90	New York State Society of Certified Public Accountants	North America

	<b>Respondent</b>	<b>Region</b>
91	Nordic Federation of Public Accountants	Europe
92	Royal Institute of Chartered Surveyors	Global
93	Self-Regulatory Organization of Auditors Association	Europe
94	South African Institute of Chartered Accountants	Middle East and Africa
95	The Finnish Association of Authorised Public Accountants	Europe
96	Wirtschaftsprüferkammer	Europe
<b>Academics</b>		<b>Total: 1</b>
97	UNSW Audit Research Network	Asia Pacific
<b>Individuals and Others</b>		<b>Total: 2</b>
98	Training and Advisory Services and Chartered Accountants Academy	Middle East and Africa
99	Vera Massarygina	Europe

## Appendix 3

### Overview of Approach to Analyzing Comments

1. While the objective and basic process of analyzing comment letters has not changed, Nvivo was used to assist with the analysis of comments. **Agenda item 4–B.1 to Agenda item 4–B.12** provide a summary of the analysis for each question. This appendix explains how comments were categorized in Nvivo.
2. The summaries reflect:
  - (a) The number of respondents who “agreed”, “agreed but conditional or with further commentary”, or “disagreed” with the question. There were also responses where it was not clear whether the respondent agreed or disagreed, which have been classified as “unclear”. It is noted that respondents classified as “agreed but conditional or with further commentary” were those who appeared to agree but had additional concerns or suggestions. Respondents who “agreed” and provided further explanations of why they agreed were classified as “agreed”.
  - (b) The general themes identified from further analyzing the comments for those respondents who “agreed but conditional or with further commentary”, “disagreed” or were “unclear”. In many cases, the additional concerns or suggestions raised by respondents who agreed were similar to the reasons provided by respondents who disagreed with the question, i.e., they had similar issues and concerns whether they agreed or disagreed. The general themes have therefore been numbered consistently across the three categories to reflect these similarities. The general themes are intended to provide an overview of key themes, and do not reflect the nuances of the individual comments. Furthermore, the general themes do not reflect one-off comments or suggestions, which have nevertheless been considered by the ISQM 1 TF.
3. **Agenda item 4–C.1 to Agenda item 4–C.4** provide the Nvivo reports that reflect the actual comments from the respondents. These have been organized as follows:
  - (a) The comments have been grouped by “agreed”, “agreed but conditional or with further commentary”, “disagreed”, and “unclear”.
  - (b) Within the groupings, the comments have been further grouped by respondent group (e.g., monitoring group, investors etc.).
4. The following points are also important for noting as part of the Nvivo analysis:
  - (a) In certain cases, respondents’ comments on a particular question were considered more relevant to another question or another aspect of ED-ISQM 1. Therefore, these comments were re-assigned to the more relevant question or aspect, so that they can be considered in the context of all other relevant comments. Furthermore, some respondents provided general comments, which were also assigned to the most relevant questions or aspects. In some cases, a comment may have been assigned to multiple areas given the relevance to multiple issues.
  - (b) There were questions where the ISQM 1 TF found the need to further bifurcate the question for the purposes of the analysis, such as questions 5, 8(a) and 12(c).
  - (c) There were questions where the respondents’ comments had extensive overlap and the ISQM 1 TF found it more practical to combine the questions, such as questions 6(b) and 6(b)(i), 6(d)

- and 6(d)(i), and 12 and 12(a). Furthermore, given the overlap of question 1 with questions 1(a), 1(b) and 1(c), comments on question 1 were allocated to questions 1(a), 1(b) and 1(c).
- (d) Additional categories were created to capture comments on other aspects of ED-ISQM 1. These categories either relate to topics not covered in the questions (e.g., certain components), or were categories created to help organize the comments for further consideration (e.g., a category was created to capture all comments related to support material). Appendix 4 of this paper provides a list of all questions and the additional categories created to address particular topics.
5. As highlighted in paragraph 1 of this paper, ninety-nine (99) letters were received. However, in order to facilitate the timely preparation of materials for the Board meeting, Staff concluded that letters received after July 26, 2019 would not be able to be included in the Nvivo analysis prepared for the Board in **Agenda item 4–B** and **Agenda item 4–C**. 1 letter was received after July 26, 2019, which has not been included in the Nvivo analysis.<sup>15</sup> The ISQM 1 TF considered the comments in the letter, and noted that there are no matters identified in the letter that highlight new matters that have not already been identified in this issues paper.

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<sup>15</sup> The Board may view this letter at [https://www.ifac.org/system/files/publications/exposure-drafts/comments/NYSSCPA\\_0.pdf](https://www.ifac.org/system/files/publications/exposure-drafts/comments/NYSSCPA_0.pdf)

## Appendix 4

### Questions and Topics to be Considered by the IAASB

The following sets out:

- The questions and topics related to ED-ISQM 1.
- The corresponding agenda paper that contains the summary of the analysis for each question or topic being presented to the Board.
- The corresponding agenda paper that provides the Nvivo reports that reflect the actual comments from the respondents for each question or topic being presented to the Board.
- When the ISQM 1 TF plans to present each question and topic to the Board for consideration.

Question or Topic	Agenda paper – summary of Nvivo analysis	Agenda paper – respondent comments	Planned timing of IAASB discussion
Question 1(a)	Agenda item 4–B.1	Agenda item 4–C.1	September 2019
Question 1(b)	Agenda item 4–B.2	Agenda item 4–C.1	September 2019
Question 1(c)	Agenda item 4–B.3	Agenda item 4–C.1	September 2019
Question 2	Agenda item 4–B.4	Agenda item 4–C.2	September 2019
Question 3	N/a	N/a	March 2020
Question 4	Agenda item 4–B.5	Agenda item 4–C.3	September 2019
Question 5	N/a	N/a	December 2019
Question 5A	N/a	N/a	December 2019
Question 6	Agenda item 4–B.6	Agenda item 4–C.4	September 2019
Question 6(a)	Agenda item 4–B.7	Agenda item 4–C.4	September 2019
Question 6(b) and 6(b)(i)	Agenda item 4–B.8	Agenda item 4–C.4	September 2019
Question 6(b)(ii)	Agenda item 4–B.9	Agenda item 4–C.4	September 2019
Question 6(c)	Agenda item 4–B.10	Agenda item 4–C.4	September 2019
Question 6(d) and 6(d)(i)	Agenda item 4–B.11	Agenda item 4–C.4	September 2019
Question 6(d)(ii)	Agenda item 4–B.12	Agenda item 4–C.4	September 2019
Question 7	N/a	N/a	December 2019
Question 8(a)	N/a	N/a	December 2019
Question 8(a).1	N/a	N/a	December 2019
Question 8(b)	N/a	N/a	December 2019
Question 9	N/a	N/a	December 2019
Question 10	N/a	N/a	December 2019
Question 11	ISQM 2 Task Force		
Question 12 and 12(a)	N/a	N/a	December 2019
Question 12(b)	N/a	N/a	December 2019

Question or Topic	Agenda paper – summary of Nvivo analysis	Agenda paper – respondent comments	Planned timing of IAASB discussion
Question 12(c)	N/a	N/a	December 2019
Question 12(c).1	N/a	N/a	December 2019
Question 12(d)	N/a	N/a	December 2019
Question 12(d)(i)	N/a	N/a	December 2019
Question 12(d)(ii)	N/a	N/a	December 2019
Question 12(e)	N/a	N/a	December 2019
Question 13	N/a	N/a	Partial September 2019, remainder December 2019
Question 14	N/a	N/a	December 2019
Question 15	N/a	N/a	March 2020
Topic 01. Introduction Topic 02. Objective Topic 03. Definitions Topic 04. General requirements Topic 05. Governance and leadership Topic 06. The firm's risk assessment process Topic 07. Relevant ethical requirements Topic 08. Acceptance and continuance Topic 09. Engagement performance Topic 10. Resources Topic 11. Information and communication Topic 12. Monitoring and remediation Topic 13. Networks Topic 14. Service providers Topic 15. Documentation Topic 16. Appendix	N/a	N/a	December 2019
Support material	N/a	N/a	March 2020

## Appendix 5

### Paragraphs from ED-ISQM 1 that are Referenced in this Paper

...

#### Definitions

19. In this ISQM, the following terms have the meanings attributed below:

...

- (t) Response (in relation to a system of quality management) – Policies or procedures designed and implemented by the firm to address an assessed quality risk: (Ref: Para. A17–A18, A62)
  - (i) Policies are statements of what should, or should not, be done to address an assessed quality risk. Such statements may be documented, explicitly stated in communications or implied through actions and decisions.
  - (ii) Procedures are actions to implement policies.

...

#### Requirements

##### Applying, and Complying with, Relevant Requirements

20. The individual(s) assigned ultimate responsibility and accountability, and the individual(s) assigned operational responsibility, for the firm's system of quality management shall have an understanding of this ISQM relevant to their responsibilities, including the application and other explanatory material, to understand the objective of this ISQM and to apply its requirements properly. (Ref: Para. A19)

...

#### Governance and Leadership

24. In designing and implementing responses to address the quality risks identified and assessed by the firm relating to the governance and leadership quality objectives, the firm shall include the following responses:

- (a) Assigning ultimate responsibility and accountability for the system of quality management to the firm's chief executive officer or the firm's managing partner (or equivalent) or, if appropriate, the firm's managing board of partners (or equivalent). The individual(s) to whom such responsibility and accountability is assigned shall: (Ref: Para. A36)
  - (i) Have the appropriate experience and knowledge to fulfill the assigned responsibility.
  - (ii) Demonstrate a commitment to quality through their actions and behaviors, including recognizing and reinforcing the importance of professional ethics, values and attitudes, and establishing the expected behavior of personnel relating to the performance of engagements and activities within the system of quality management. (Ref: Para. A26–A28)

- (iii) Establish structures, reporting lines, and appropriate authorities and responsibilities, including assigning operational responsibility for the following matters to personnel who fulfill the requirements in paragraph 25: (Ref: Para. A37–A39)
  - a. The system of quality management as a whole; and
  - b. Specific aspects of the system of quality management, as appropriate to the nature and circumstances of the firm, which shall include operational responsibility for compliance with independence requirements and the monitoring and remediation process.

...

25. The personnel assigned operational responsibility for the matters set out in paragraph 24(a)(iii) shall have: (Ref: Para. A39)
- (a) The appropriate experience and knowledge and sufficient time to fulfill their assigned responsibility;
  - (b) A direct line of communication to the individual(s) assigned ultimate responsibility and accountability for the system of quality management; and
  - (c) An understanding of their assigned responsibilities and accountability for such responsibilities.

...

#### **The Firm's Risk Assessment Process**

...

30. The firm shall design and implement responses to address the assessed quality risks, including the responses required by this ISQM. The design of the responses shall be based on, and responsive to, the reasons for the assessments given to the quality risks. (Ref: Para. A48, A59–A64)

#### *Changes in the Nature and Circumstances of the Firm or its Engagements*

31. The firm shall identify changes in the nature and circumstances of the firm or its engagements and modify the quality objectives, quality risks or responses, as appropriate, in response to such changes. (Ref: Para. A48, A65–A66)

...

#### **Relevant Ethical Requirements**

...

33. In designing and implementing responses to address the quality risks identified and assessed by the firm relating to the relevant ethical requirements quality objectives, the firm shall include the following responses: (Ref: Para. A68–A69 and A75)

...

- (d) Obtaining, at least annually, a documented confirmation of compliance with independence requirements from all personnel required by relevant ethical requirements to be independent.

...

## Engagement Performance

36. The firm shall establish the following quality objectives that address the performance of quality engagements:
- (a) Personnel understand and fulfill their responsibilities in connection with the engagement, including, as applicable:
    - (i) The engagement partner's overall responsibility for managing and achieving quality on the engagement and for being sufficiently and appropriately involved throughout the engagement; and (Ref: Para. A91)
    - (ii) The appropriate direction and supervision of the engagement team and review of the work performed. (Ref: Para. A92–A93)
  - (b) Engagement teams exercise appropriate professional judgment and, when applicable to the type of engagement, professional skepticism, in planning and performing engagements such that conclusions reached are appropriate. (Ref: Para. A94–A97)
  - (c) The engagement documentation is appropriately assembled and retained.
37. In designing and implementing responses to address the quality risks identified and assessed by the firm relating to the engagement performance quality objectives, the firm shall include the following responses:
- (a) Establishing policies or procedures addressing the nature, timing and extent of the direction and supervision of engagement teams and review of their work, including that such direction, supervision and review is planned and performed on the basis that the work performed by less experienced members of the engagement team is directed, supervised and reviewed by more experienced engagement team members. (Ref: Para. A92–A93)
  - (b) Communicating to engagement teams their responsibility for planning and performing the engagement in accordance with professional standards and applicable legal and regulatory requirements.
  - (c) Establishing policies or procedures addressing consultation on difficult or contentious matters, including the engagement team's responsibilities for consultation, the matters on which consultation is required and how the conclusions should be agreed and implemented. (Ref: Para. A95, A98–A99)
  - (d) Establishing policies or procedures addressing differences of opinion that arise within the engagement team, or between the engagement team and the engagement quality reviewer or personnel performing activities within the firm's system of quality management, including those who provide consultation. (Ref: Para. A95, A100)
  - (e) Establishing policies or procedures addressing engagement quality reviews in accordance with ISQM 2, and that require an engagement quality review for: (Ref: Para. A101–A107)
    - (i) Audits of financial statements of listed entities;
    - (ii) Audits of financial statements of entities that the firm determines are of significant public interest; and
    - (iii) Audits or other engagements for which:

- a. An engagement quality review is required by law or regulation; or
  - b. The firm determines that an engagement quality review is an appropriate response to assessed quality risks, based on the reasons for the assessments given to those risks.
- (f) Establishing policies or procedures addressing assembly and retention of documentation that require:
- (i) The engagement files to be assembled within an appropriate period of time after the engagement reports have been finalized; and (Ref: Para. A108)
  - (ii) The engagement documentation to be retained and maintained to meet the needs of the firm and to comply with law, regulation, relevant ethical requirements, or other professional standards. (Ref: Para. A109–A112)

...

### **Information and Communication**

40. The firm shall establish the following quality objectives that address obtaining, generating or using information regarding the system of quality management, and communicating information within the firm and to external parties on a timely basis to enable the design, implementation and operation of the system of quality management: (Ref: Para. A135)
- (a) The firm has an information system that supports the system of quality management by identifying, capturing, processing and maintaining relevant and reliable information, whether from internal or external sources. (Ref: Para. A136–A138)
  - (b) The firm communicates relevant and reliable information to personnel, the nature, timing and extent of which is sufficient to enable personnel to understand and carry out their responsibilities relating to the performance of engagements or activities within the system of quality management. (Ref: Para. A139)

...

### **Monitoring and Remediation Process**

42. The firm shall establish the following quality objectives that address the firm's monitoring and remediation process that enable the evaluation of the design, implementation and operation of the components of the system of quality management to determine whether the quality objectives have been achieved: (Ref: Para. A154–A155)
- (a) The firm's monitoring and remediation process provides relevant, reliable and timely information about the design, implementation and operation of the components of the system of quality management.
  - (b) The firm takes appropriate actions to respond to identified deficiencies such that deficiencies are remediated on a timely basis.
  - (c) The individual(s) assigned ultimate responsibility and accountability for the system of quality management evaluates whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.

43. In designing and implementing responses to address the quality risks identified and assessed by the firm relating to the monitoring and remediation quality objectives, the firm shall include the responses in paragraphs 44–57.

*Designing and Performing Monitoring Activities*

44. The firm shall determine the nature, timing and extent of the monitoring activities, including the appropriate combination of ongoing and periodic monitoring activities. In designing and implementing the monitoring activities, the firm shall take into account: (Ref: Para. A156–A159)
- (a) For a response, the related assessed quality risk(s), the reasons for the assessments given to the quality risk(s) and the design of the response; (Ref: Para. A160–A161)
  - (b) For monitoring activities over the firm's risk assessment process, the design of that process;
  - (c) Changes in factors that have affected the firm's system of quality management or changes in the system of quality management; (Ref: Para. A162)
  - (d) Previous monitoring activities and remedial actions, including whether previous monitoring activities continue to be relevant in evaluating the firm's system of quality management; and (Ref: Para. A163–A164)
  - (e) Other relevant information, including concerns identified regarding the commitment to quality of the firm or its personnel and information from external inspections. (Ref: Para. A165–A167)
45. The firm's monitoring activities shall include the inspection of engagements to determine whether the responses that are required to be implemented at the engagement level have been implemented. Engagement inspections may include the inspection of in-process or completed engagements. In determining the nature, timing and extent of the inspection of engagements, the firm shall: (Ref: Para. A168–A170)
- (a) Take into account the relevant factors in paragraph 44; and
  - (b) Include the inspection of at least one completed engagement for each engagement partner on a cyclical basis determined by the firm.
46. The firm shall establish policies or procedures that:
- (a) Require those performing the monitoring activities to have the competence and capabilities, including sufficient time, to perform the monitoring activities effectively; and
  - (b) Address the objectivity of the individuals performing the monitoring activities. Such policies or procedures shall prohibit the engagement team members or the engagement quality reviewer of an engagement from performing any inspection of that engagement. (Ref: Para. A171)

*Evaluating Findings and Identifying Deficiencies*

47. The firm shall establish policies or procedures addressing the evaluation of the findings arising from the monitoring activities, the results of external inspections and other relevant information to determine whether deficiencies exist, including in the monitoring and remediation process. (Ref: Para. A165, A172–A177)

### *Evaluating Identified Deficiencies*

48. The firm shall establish policies or procedures addressing:
- (a) The investigation of the root cause(s) of the identified deficiencies, including that the nature, timing and extent of the procedures to be performed to investigate the root cause(s) take into account the nature of the identified deficiencies and their possible severity; and (Ref: Para. A178–A182)
  - (b) The evaluation of the severity and pervasiveness of the identified deficiencies, including the effect of the identified deficiencies, individually and in aggregate, on the system of quality management as a whole. (Ref: Para. A183)

### *Responding to Identified Deficiencies*

49. The firm shall design and implement remedial actions to address identified deficiencies that are responsive to the results of the root cause analysis. In doing so, the firm shall determine whether the firm's quality objectives, assessed quality risks and responses remain appropriate and modify them, as appropriate. (Ref: Para. A184)
50. The individual(s) assigned operational responsibility for monitoring and remediation shall evaluate whether the remedial actions are appropriately designed to address the identified deficiencies and their related root cause(s) and determine whether they have been implemented. The individual shall also evaluate whether the remedial actions implemented to address previously identified deficiencies are effective. (Ref: Para. A163)

### *Findings About a Particular Engagement*

51. In circumstances when a finding relates to an in-process or completed engagement and there is an indication that procedures required were omitted during the performance of the engagement or the report issued may be inappropriate, the firm shall: (Ref: Para. A185)
- (a) Take appropriate action to comply with relevant professional standards and applicable legal and regulatory requirements; and
  - (b) When the report is considered to be inappropriate, consider the implications and take appropriate action, including considering whether to obtain legal advice.

### *Ongoing Communication Related to Monitoring and Remediation*

52. The individual(s) assigned operational responsibility for the monitoring and remediation process shall communicate on a timely basis to the individual(s) assigned ultimate responsibility and accountability for the system of quality management and the individual(s) assigned operational responsibility for the system of quality management: (Ref: Para. A186)
- (a) A description of the monitoring activities performed;
  - (b) The identified deficiencies, including the severity and pervasiveness of such deficiencies; and
  - (c) The remedial actions to address the identified deficiencies.
53. The firm shall communicate the matters described in paragraph 52 to personnel to the extent that the information is relevant to their responsibilities to enable the personnel to take prompt and appropriate action in accordance with their responsibilities. (Ref: Para. A187)

54. The firm shall communicate information about the results of the firm's monitoring and remediation process to external parties on a timely basis, in accordance with paragraph 41(c).

*Evaluating the System of Quality Management*

55. The individual(s) assigned ultimate responsibility and accountability for the system of quality management shall evaluate whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved. This evaluation shall take into account: (Ref: Para. A188–A189)
- (a) The severity and pervasiveness of identified deficiencies; and
  - (b) The evaluation in paragraph 50 regarding whether the remedial actions are appropriately designed to address the identified deficiencies and their related root cause(s), and have been implemented.
56. The evaluation in paragraph 55 shall be undertaken at least annually, or more frequently when the identified deficiencies are of a severity and pervasiveness that indicate that the system may not be providing reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.
57. If the evaluation indicates that the system of quality management does not provide reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved, the individual(s) assigned ultimate responsibility and accountability for the system of quality management shall:
- (a) Take prompt and appropriate action in accordance with their responsibilities; and
  - (b) Communicate to: (Ref: Para. A190–A191)
    - (i) Personnel to the extent that it is relevant to their responsibilities; and
    - (ii) External parties in accordance with the firm's policies or procedures required by paragraph 41(c).

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