



ISQM 1: Overview of Feedback from the Exposure Draft and Outline of Proposals in Proposed ISQM 1

Presented by:
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IAASB CAG Meeting March 2020
Agenda Item B

The Firm's Risk Assessment Process (FRAP) and the Approach to Quality Objectives and Responses

FRAP and the Approach to Quality Objectives and Responses

- Respondent feedback on the FRAP presented to the CAG in September 2019
- Proposals discussed with the CAG in September 2019:
 - Relocate FRAP as the first component
 - Emphasize that the FRAP is a process in nature (new requirement for the firm to establish FRAP)
 - Revise requirement for firm to establish additional quality objectives to a “consideration” (more of a bottom-up approach)
 - Simplify the FRAP – condense the two-step process for risk identification and assessment into a single requirement
 - Revise threshold for identifying and assessing quality risks and relocate threshold to the definition
 - Streamline requirements in the components by:
 - Revising quality objectives in the components to be higher level
 - Reducing responses in the components (e.g., duplication with quality objectives)
 - Introduce concept of quality risk considerations (bridges gap between quality objectives and responses)

FRAP and the Approach to Quality Objectives and Responses (continued)

- Further proposals since September 2019 related to the FRAP:
 - Quality risk considerations – adjusted to describe them as “factors that may adversely affect the achievement of the firm’s quality objectives”
 - Factors are focused on the nature and circumstances of the firm and the engagements performed by the firm
 - Includes examples of factors in the application material
 - Factors promote proactivity, scalability (upwards and downwards) and tailoring the SOQM
 - Factors also may drive a more robust risk identification and assessment process (i.e., clearer what the firm needs to consider and may help with more consistent implementation)
 - Clarified how the factors may affect the identification and assessment of quality risks
 - May assist firms in “thinking through” what quality risks may arise
 - Clarified requirement addressing designing and implementing responses
 - Enhanced requirement addressing modifications to the quality objectives, quality risks or responses to clarify the intent of the requirement and encourage firms to proactively identify when changes are needed
 - New application material explaining the types of information sources that may be used by the firm in the FRAP (emphasizes the continual flow of information across the SOQM)

FRAP and the Approach to Quality Objectives and Responses (continued)

- Further proposals since September 2019 related to the approach to quality objectives and responses in the components:
 - Streamlined the quality objectives and responses by:
 - Grouping quality objectives
 - Reducing duplication between quality objectives and responses (e.g., the responses were subsumed into the quality objectives)
 - Converting responses to quality objectives, or moving aspects of the responses into the quality objectives
 - Relocating more granular aspects of the requirements to application material
 - Resulted in only five prescribed responses remaining – relocated all responses to a separate section “specified responses”
 - Some of the responses relate to more than one component so better to be grouped
 - Minimal responses remain - evident that firms need to design and implement responses in addition to those in the standard – more robust, and better supports a risk-based approach and scalability
 - Enhances the focus on the quality objectives in the components and achieving them – also more principles-based and risk-based

Questions for Representatives

Question 1

Representatives are asked to share their views on how proposed ISQM 1 addresses the identification and assessment of quality risks (see paragraph 22E of Agenda Item B.3), in particular:

- (a) The introduction of factors focused on the nature and circumstances of the firm and the engagements it performs; and
- (b) Whether the proposals are likely to assist firms in “thinking through” the risk identification and assessment process.

Question 2

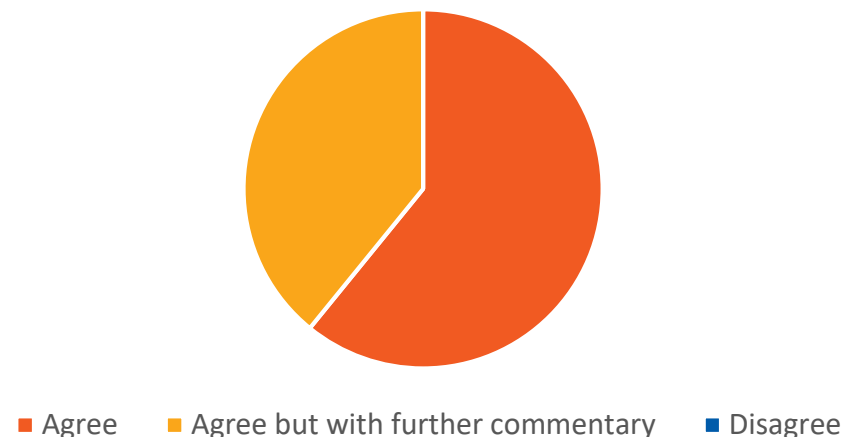
Representatives are asked to share their views about the approach taken to streamline the quality objectives and responses across the components (see paragraphs 23, 32, 34, 36, 38, 40 and 41A of Agenda Item B.3).

Monitoring and Remediation (M&R)

M&R – Summary of Respondent Feedback - M&R Overall

- MG:
 - Improved clarity of the process
 - Greater emphasis is needed on preventative responses.
- Other respondents:
 - Potential to improve robustness of firms' monitoring and remediation and encourages proactive and effective monitoring
 - Some skeptical about whether will encourage innovation
 - Mixed views on flexibility of the requirements
 - Concerns about extent of change in the component, creating the need for a sufficient implementation period
 - Suggested developing guidance on the monitoring and remediation process to support firms in developing proactive and innovative monitoring techniques and use of examples

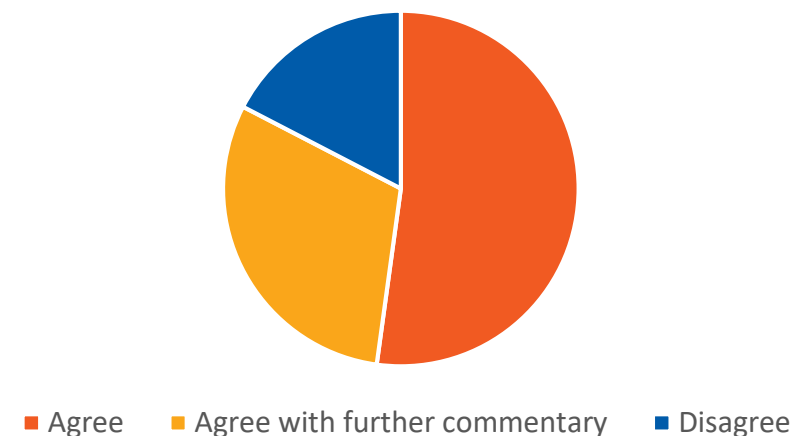
Q12 Monitoring and Remediation



M&R: Summary of Respondent Feedback - Inspection of Completed Engagements

- Respondents generally supported:
 - Improved flexibility of the requirement and focus on other types of reviews
- Concerns
 - Needs to be more focused on risk than a cyclical period
 - Unintended consequences of reference to three-year cycle - interpreted as a de facto requirement
 - Reference to in-process reviews in the requirement is confusing as they are not required

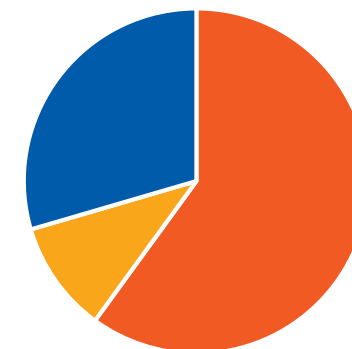
Q12(b) M&R inspection of completed engagements



M&R: Summary of Respondent Feedback: Findings and Deficiencies

- MG:
 - Definition of deficiencies is over-engineered and complex
- Other respondents:
 - Mixed views on whether the framework for evaluating findings and identifying deficiencies is clear
 - Mixed views on definition of deficiencies
 - Lack of distinction between a “deficiency” and a “finding”
 - Suggested introducing a definition of finding or clarifying factors to consider in determining whether a finding is a deficiency
 - Clarify the iterative nature of identifying and evaluating deficiencies and undertaking a root cause analysis
 - With respect to evaluating the severity and pervasiveness of deficiencies – suggestions to:
 - Address the varying severity of deficiencies, such as introducing concept of “significant deficiencies”
 - Provide guidance to explain how the severity of deficiencies affects the annual evaluation of the SOQM
 - Also suggested developing implementation support and to use the diagrams in the explanatory memorandum in supporting material

Q12(c) Evaluating Findings and Identifying Deficiencies

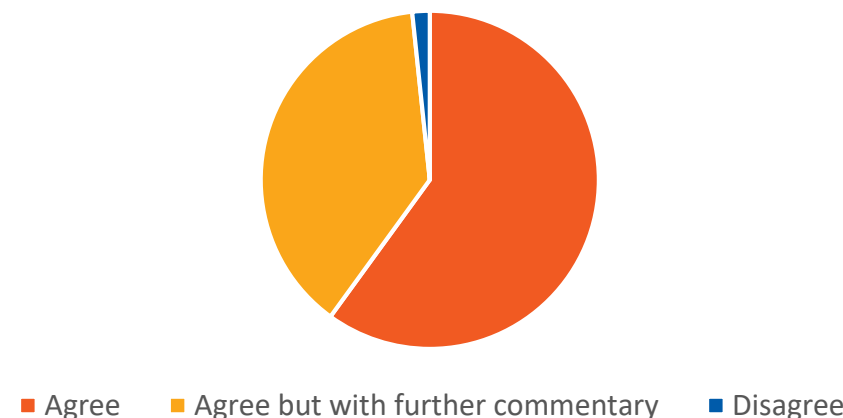


■ Agree ■ Agree but with further commentary ■ Disagree

M&R: Summary of Respondent Feedback: Investigating Root Causes

- MG:
 - Support for new requirements
 - Suggested also addressing good practice
- Other respondents:
 - Support for new requirements, and also indicated they are sufficiently flexible
 - Clarify the scope for investigating root causes
 - Guidance needed to support consistent implementation (varying views on what it entails)
 - Support for how standard addresses positive findings, although some suggestions to further clarify and enhance the emphasis on positive findings

Q12(d) Investigating Root Causes



M&R: Proposals Since ED

- Specified that the firm needs to establish a M&R process – purpose is to clarify that it is a process by nature
- Enhanced risk-based approach to encourage proactive, scalable and preventative approach, and improve robustness and timeliness of monitoring
 - Directly stated the quality risk for monitoring activities in lead-in of paragraph 44
 - Other requirements, e.g., investigating root causes – risk is already embedded because focus is on deficiencies
- Inspection of completed engagements:
 - Focused more on a risk-based selection, and enhanced focus on considering firm's other monitoring activities
 - Application material suggesting a three-year cycle to select engagement partners – reworked to demonstrate how a cycle may be flexed (upwards and downwards) because of risk
 - Removed reference to inspection of in-process engagements.

M&R: Proposals Since ED (continued)

- Findings and deficiencies
 - Revised and simplified definition of deficiencies
 - New definition for findings
 - Further clarification of evaluating findings and identifying deficiencies:
 - New application material emphasizes need for professional judgment in determining whether findings are deficiencies
 - Emphasized iterative nature of evaluating findings and identifying deficiencies and investigating root cause
- Positive findings – adjusted terminology to distinguish from negative findings, and explained how contrasting circumstances may be useful in investigating root cause
- Moved “evaluating the SOQM” to a separate section
 - Includes new application material explaining how the severity and pervasiveness of deficiencies may affect the evaluation

Questions for Representatives

Question 3:

Representatives are asked to share their views on the following aspects of monitoring and remediation:

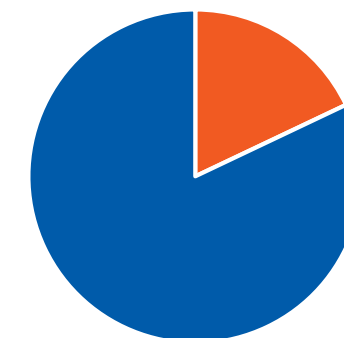
- (a) How a risk-based approach has been embedded in monitoring and remediation (see paragraph 44 of Agenda Item B.3);
- (b) The proposals addressing the inspection of completed engagements (see paragraphs 45 and A168–A170 of Agenda Item B.3);
- (c) Whether the framework for evaluating findings and identifying deficiencies has been clarified (see paragraphs 19(a), 19(gA) and A173–A177 of Agenda Item B.3).

Evaluation of the SOQM

Evaluation of the SOQM: Summary of Respondent Feedback

- Overall feedback: requirement will present challenges for implementation:
 - Frequency of evaluation challenging, and clarity needed on when it needs to be undertaken more often than annually
 - Expectations on leadership (an individual) burdensome
 - Self-assessment (creates a self-review threat)
 - Gathering the information and documentation also challenging
 - Questions about “what is reasonable assurance”
 - Clarity needed on how severity and pervasiveness of deficiencies affects the evaluation
 - Also lack of clarity about the following
 - Ongoing evaluation or point-in-time evaluation
 - Evaluation of the process or the outcome of the process
 - Based on a “period ended” or an “as of date”

Q12(e) Challenges in fulfilling Requirement to Evaluate the System of Quality Management



■ No challenges ■ Challenges

Evaluation of the SOQM: Proposals Since ED

- Relocated from the “monitoring and remediation” component - reinforces leadership’s responsibility and accountability for the SOQM
 - In application material clarified the purpose of the evaluation, and that “reasonable assurance” is not an independent or external form of assurance.
 - Also relocated requirement for performance evaluations of leadership to this section (previously in G&L)
- Clarified the requirement for the evaluation – separated into two parts:
 - Leadership’s evaluation of the SOQM, i.e., gathering and considering the information
 - Leadership’s conclusion on whether the SOQM provides the firm with reasonable assurance that the objectives of the SOQM are being achieved
- Addressed comments about the timing of the evaluation:
 - Frequency of evaluation focused on minimum frequency (annually)
 - Clarified that is undertaken at a point in time – evaluation is indication whether the SOQM provides the firm with reasonable assurance that the objectives of the system **are being** achieved
- Provided guidance to explain matters that may be considered in concluding on the SOQM (includes how severity and pervasiveness of deficiencies affects the evaluation)

Questions for Representatives

Question 4:

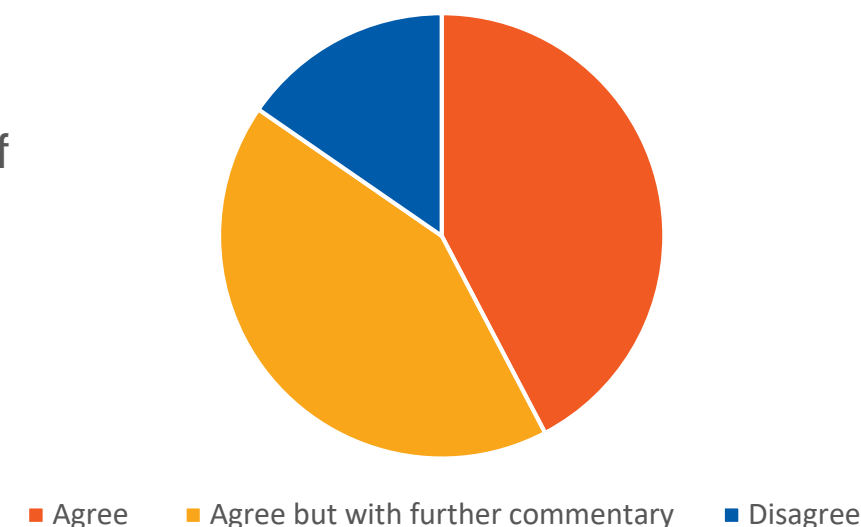
Representatives are asked to share their views about the proposals addressing firm leadership's evaluation of the SOQM (see paragraphs 65A–65C and A209A–A210DD of Agenda Item B.3).

External Communications (Including Transparency Reports)

External Communication: Summary of Respondent Feedback

- MG:
 - Require transparency disclosures to enhance enforceability
- Other respondents
 - Support for requirements promoting and encouraging exchange of valuable and insightful information about the SOQM
 - Mixed views about reference to transparency reports
 - Certain respondents seeking more robust requirements for external communication
 - Others concerned about reference to transparency reports in the requirement – creates a de facto requirement and other forms of communication may be more appropriate
 - Further suggestions:
 - Clarify the external parties with whom the firm may communicate
 - Address the content of the report or how it should be prepared
 - Address audit quality indicators
 - Some concerns with term “information system” - implies a complex and formal infrastructure

Q10 Communication with External Parties



External Communications: Proposed Way Forward

- Intention in ED: Encourage firms to communicate externally via a transparency report (TR) when it is appropriate to do so
- Underlying theme in comments: either explicitly require it, or remove it
 - Manner in which it was described lacks clarity
- ISQM 1 TF undertook further information gathering on effectiveness and usefulness of TR and how they have evolved
 - Varied evidence of the extent to which TR are being used by intended users
 - Nature and granularity of information communicated, and tone and volume reports varies across firms and jurisdictions – information communicated has evolved over the years
- If require TR
 - Inappropriately focuses on TR as being sole means of communication
 - Framework would need to be developed given varying views about what information a TR should provide
 - more work would need to be done to establish what is meaningful
 - Could stifle further innovation, and result in periodic communications that may not include the most relevant or timely information

External Communications: Proposed Way Forward (continued)

- ISQM 1 TF view:
 - Focus should be on:
 - Firms proactively communicating externally in a timely manner, in whatever form and manner is most appropriate (i.e., not necessarily a TR)
 - The information being communicated being appropriate and relevant in the circumstances
 - Principles-based approach is needed, i.e., ISQM 1 should not require TR, but describe them as a form of communication in the application material

Questions for Representatives

Question 5

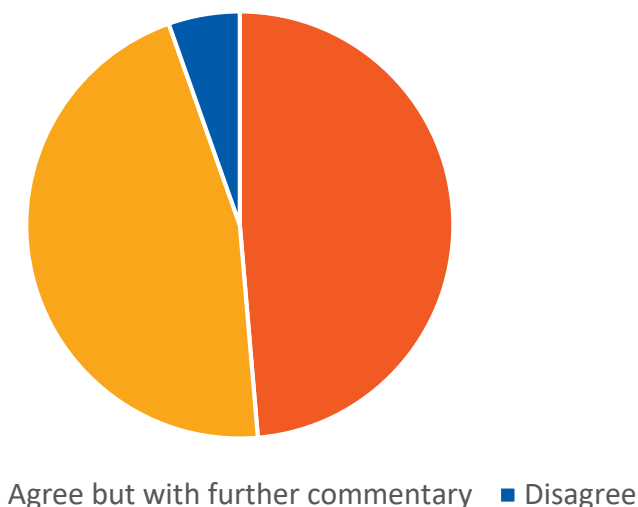
Representatives are asked to share their views on the proposed way forward for addressing external communications by the firm, in particular as it relates to transparency reporting (see section B.11 of Agenda Item 4 of the IAASB March 2020 meeting).

Networks

Networks: Summary of Respondent Feedback

- MG:
 - Support for proposals
 - One member noted that the standard is not sufficiently robust in addressing the firm's responsibilities
 - Two members emphasized need for network-level to be subject to inspections, with one suggesting there should be requirements in the standard for the network – concerns that
 - Network requirements or network services (NR&S) form part of firm's SOQM
 - Consistency across the network, and the network should ensure this is the case
- Other respondents:
 - Support for proposals – will address the issue of firms placing undue reliance on NR&S
 - Emphasis that firm is responsible for its SOQM
 - Observations about impact on the network – e.g., more consistency, improved communication, improved understanding of NR&S and firms' SOQMs and indirect pressure for networks to remediate deficiencies in a timely manner

Q13 Networks



Networks: Summary of Respondent Feedback (continued)

- Other respondents (continued):
 - Some challenges highlighted, e.g., consistent application across the network, obtaining information from the network
 - Harmonization with other jurisdictions important

Networks: Proposals to Address Concerns about the Network Level

- New requirement in proposed ISQM 1 for the firm to obtain information from the network about how the network determines that network requirements have been appropriately implemented across the network firms
- Better understand how proposed ISQM 1 will impact networks – what are the implementation activities, how will networks support network firms, and how will there be an impact on the network
 - Undertook outreach with 10 global networks to gather input on the impact on networks
 - Plan is to share outreach feedback with MG members (some outreach already completed)
 - All outreach feedback will be considered in balancing competing and important objectives related to networks, i.e.:
 - Firms determining whether NR&S need to be adapted or supplemented to be appropriate for use (i.e., the issue of undue reliance on networks)
 - Promoting consistency of quality across networks, through promoting firms' use of network requirements and the network undertaking monitoring activities to determine that network requirements have been appropriately implemented across the network firms

Networks: Outreach Feedback from the Firms Regarding the Impact on Networks

- Some networks are already planning for the implementation of ISQM 1 - project teams, documenting processes and awareness-building
- Important that ISQM 1 is clear and succinct as will help support consistent application across network
- New standard is creating multiple opportunities
 - Firm wide buy-in – networks actively engaging leadership and emphasizing their responsibility for the SOQM, also many activities being undertaken to build awareness of the changes, including in other business practices
 - Re-evaluation of current activities and how can be improved, including to drive commonality
 - Increased emphasis and recognition that firm is responsible for their SOQM and network's role is to support the firm
- Impact or expected impact at network level
 - Networks will need to enhance resources to support implementation and maintenance
 - Networks focused on documenting network requirements and services
 - Two-way communication very important; network will need to be more agile and nimble in responding

Networks: Outreach Feedback from the Firms Regarding the Impact on Networks

- Impact or expected impact at network level (continued):
 - Monitoring of network requirements and services – a portion will be monitored through engagements, and some will need to be monitored at the network level (e.g., similar to internal audit function)
 - Questions arising about whether, and if so what, assurance network needs to provide network firms
- How network will approach implementation and support firms
 - Approaches include looking for good practices in network firms that can globalize or network facilitating knowledge sharing between network firms
 - Encouragement of firms to start planning for implementation, and not only rely on support from network
 - Varying approaches of extent to which networks may set common quality objectives, quality risks and responses
 - Expectation will be that firms supplement what is provided to address jurisdictional circumstances
 - Varying types of networks – networks are not all established in the same way or provide the same network requirements or network services – e.g., ‘big 6’ approach may be different from others
 - Some ‘non big 6’ networks currently less prescriptive about what network firms are required to do but this may evolve

Networks: Other Proposals since ED

- Clarified how NR&S may need to be adapted or supplemented, and work effort needed to support the evaluation of NR&S
- Simplified requirements
- Clarified firm's responsibilities related to deficiencies in NR&S (also to improve linkage with M&R)
- Clarified extent and granularity of information expected to obtain from the network about the overall scope and results of the monitoring activities across the network firms' SOQM

Questions for Representatives

Question 6:

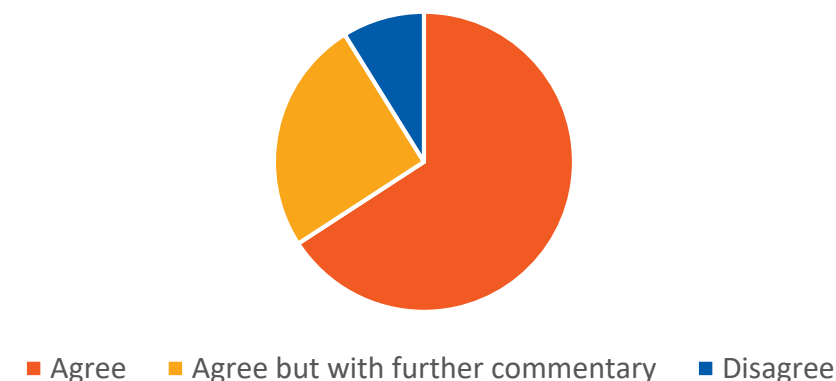
Representatives are asked to share their views on the proposed way forward in addressing networks, in particular the approach to addressing certain respondents' comments on more robust actions at the network level (see section B.13 of Agenda Item 4 of the IAASB March 2020 meeting)

Public Interest

Objective of the Standard and Reference to Public Interest

- MG:
 - Support for increased emphasis on public interest, but some suggestion that it should go further, including suggestions that it could be more prominent or should be in the objective of the standard
- Other respondents:
 - Support for the objective of the standard
 - Clarity needed on different objectives (objective of the system and objective of the standard)
 - Certain suggestions to include public interest in the objective
 - Mixed views on reference to public interest
 - Concerns about lack of common understanding of public interest
 - Also certain suggestions that standard could go further

Q5 Objective of the Standard



Q5A Reference to Public Interest



Public Interest: Proposals since ED

- Overall mixed views
- Bring prominence to public interest - restructured paragraph 7 so that it is described first
- Reference to public interest in the objective – ISQM 1 TF not proposing this change
 - Public interest is not defined or explained, and without explicit criteria, a reference to acting in the public interest in the objective would result in an objective that is not capable of being consistently measured, observed or attained

Questions for Representatives

Question 7:

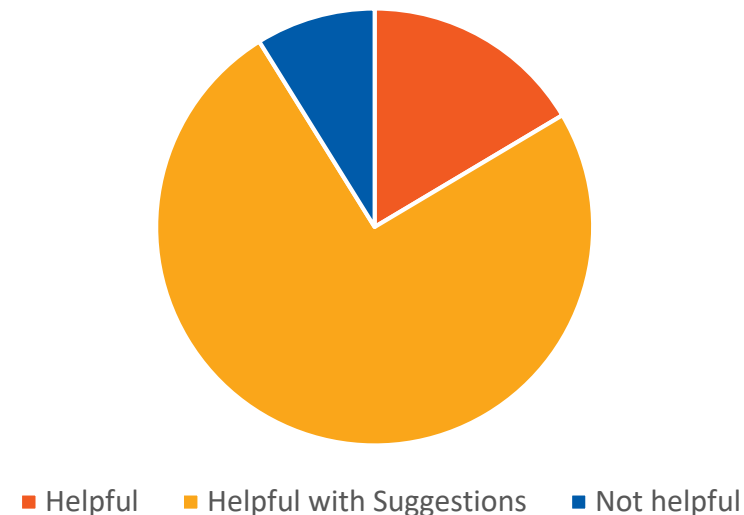
Do Representatives support the proposals to address respondents' comments on public interest (see section B.4 of Agenda Item 4 of the IAASB March 2020 meeting)?

Actions taken to address scalability,
tailoring the SOQM to the firm's
circumstances, complexity,
prescriptiveness and developing a
standard that can be applied in all
circumstances

Application Material: Summary of Respondent Feedback

- Respondents found the application material helpful
- Recommendations:
 - Reduce the length of the application material
 - Developing more guidance or examples to demonstrate how the standard is scalable
 - Repurpose some material from the explanatory memorandum into the standard or support materials, particularly the diagrams

Q3 Application Materials



Scalability, Prescriptiveness, Complexity, Tailoring, Applicability: Proposals since ED

- Key focus area of the ISQM 1 TF
 - The scalability of the standard and encouraging firms to appropriately tailor the SOQM for their circumstances
 - The complexity and prescriptiveness of the requirements
 - Developing a standard that can be applied in all circumstances, including when firms only perform related services engagements
- Application material
 - Removed application material that is non-essential – may be reused in implementation support materials
 - Relocated examples to boxes to assist in readability
 - Examples also highlight scalability examples
- ISQM 1 TF prepared a table to indicate how the various revisions to proposed ISQM 1 address the key focus areas (see Appendix D of Agenda Item B)

Questions for Representatives

Question 8:

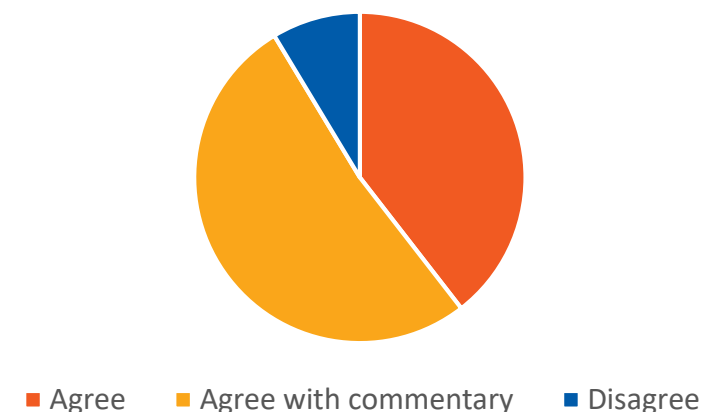
Representatives are asked to share their views on the actions taken to address respondents' concerns about scalability, tailoring the SOQM to the firm's circumstances, complexity, prescriptiveness and developing a standard that can be applied in all circumstances (see Appendix D of Agenda Item B). In particular, are Representatives of the view that these actions appropriately address these concerns?

Feedback from Respondents on Other Sections of ED-ISQM 1

Governance and Leadership (G&L)

- MG: Positive response on how the standard addresses G&L
 - Recommend enhancements to enhance firm's culture, add more quality objectives addressing leadership oversight over other components, consider appointing qualified and experienced external persons to the firms governing body
- Other respondents: General support, positive about focus on responsibility and accountability of leadership and addressing the tone at the top
 - Concerns:
 - Scalability and implementation for SMPs
 - Level of prescriptiveness and may potentially drive compliance approach
 - Suggestions included:
 - Guidance to demonstrate how this would apply for SMPs
 - Addressing the need to integrate the SOQM into the firm's business processes (e.g., human resources)
 - Clarifying what is intended by “appropriate experience and knowledge”

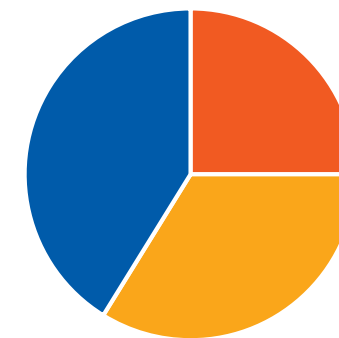
Q7 Governance and Leadership



Responsibility for Independence, Relevant Ethical Requirements, Network Independence

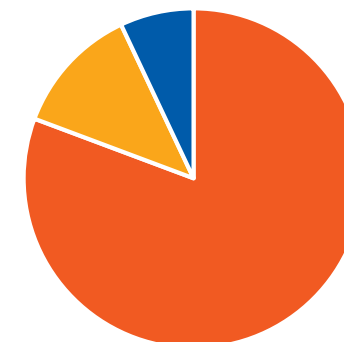
- Mixed views about requirement to assign responsibility for relevant ethical requirements and/or independence
 - Concerns that firms should be given flexibility and suggestions that the need for the role should be driven by risk
 - Relevant ethical requirements – broader than independence and covers multiple roles in the firm (e.g., human resources)
 - Overall, more support for assigning responsibility for independence than relevant ethical requirements
- Support for how ISQM 1 addresses the responsibilities of the firm regarding the independence of other firms or persons within the network

Q8 Assign Relevant Ethical Requirements to an individual



■ Agree ■ Agree but with further commentary ■ Disagree

Q8(a) Network Independence

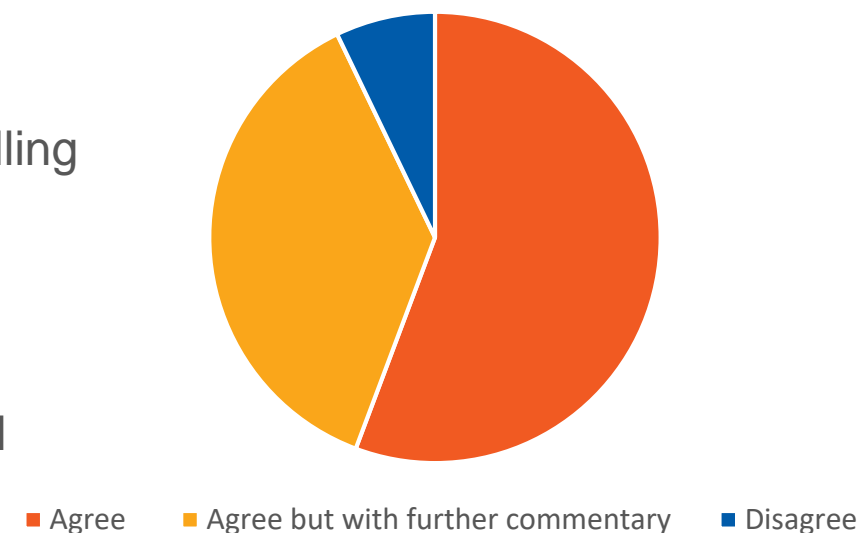


■ Agree ■ Agree but with further commentary ■ Disagree

Resources (Including Technology)

- MG:
 - Support for expanding resources to include technology
 - Need to address how tools are used, responsibilities of engagement partners, managing the use of technology and upskilling personnel
 - More explicitly address the use of service delivery centers
- Other respondents:
 - Support for inclusion of technology – flexible and principles-based
 - Clarify the scope of technology
 - Could go further, e.g., address risks arising from technology

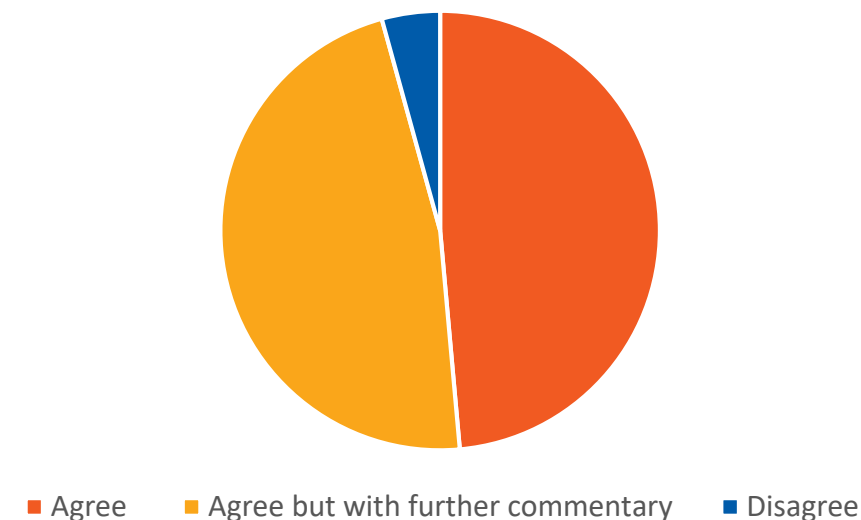
Q9 Technology



Service Providers

- Support for addressing service providers
- Clarity needed on scope of service providers – should not be too onerous
- Challenges in obtaining information from service providers
- Request for additional guidance or clarity about how the requirements should be implemented, including what to do if unable to obtain the appropriate information from the service provider

Q14 Service Providers



Other additional comments

- Varying comments on documentation
 - Some seeking more specific requirements
 - Others indicated requirements too onerous
 - Suggestions to clarify the documentation expectations, in the standard or guidance
- Clarify the relationship of the three quality management standards
- Reduce the length of the introduction
- Questioned the purpose of the appendix
- Support for change in title to “ISQM” although noted that could be challenging in certain jurisdictions where there is legislation that refers to the title

Questions for Representatives

Question 9:

Representatives are asked whether there are any other matters that should be considered by the Board before finalizing proposed ISQM 1?



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