

Meeting: IAASB Consultative Advisory Group (CAG)
Meeting Location: Virtual Zoom Meeting
Meeting Date: March 8–9, 2021

Agenda Item E.1

ISQM 1¹ – Cover and Report Back

Objective of Agenda Item

1. The objective of this agenda item is to provide a report back on comments of the Representatives on ISQM 1, as discussed at the September 2020 meeting.

Project Status

2. At its meeting in September 2020, the IAASB approved ISQM 1. Systems of quality management in compliance with ISQM 1 are required to be designed and implemented by December 15, 2022.
3. The [final pronouncement of ISQM 1](#) was formally released by the IAASB on December 17, 2020 after receiving confirmation from the Public Interest Oversight Board (PIOB) that due process was followed. It was issued together with a [Basis for Conclusions](#) and a [Fact Sheet](#).
4. The IAASB has published a plan for the [development of implementation support materials](#). To date, the IAASB has issued introductory videos with an overview of the quality management standards, which are available in English, French and Spanish. A Chinese version will be published soon. The IAASB has also developed a dedicated webpage that will provide a central location for stakeholders to access all material on the quality management standards (www.iaasb.org/focus-areas/quality-management).
5. **Appendix A** to this paper provides a history of previous discussions with the IAASB CAG and the IAASB on this topic, including links to the relevant IAASB CAG documentation.

Feedback

6. Extracts from the draft September 2020 IAASB CAG meeting minutes, as well as an indication of how the IAASB has responded to the Representatives' comments, are included in the table below.

¹ International Standard on Quality Management (ISQM) 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*

Representatives' Comments	ISQM 1 Task Force / IAASB Response
OBJECTIVE OF PROPOSED ISQM 1	
<p>Mr. Dalkin emphasized the importance of the message about the public interest and the connection to the objective of the standard, as set out in paragraph 15 of proposed ISQM 1. He noted that the issue relates to its appropriate location in the standard. Mmes. McGeachy, Zietsman and Wei supported the location of paragraph 15 of proposed ISQM 1. Ms. Zietsman emphasized that the objective of the standard needs to be measurable so that it can be implemented in a consistent way by firms. Mr. Munter indicated that he did not have a strong preference for the placement of the paragraph, and noted that the emphasis on public interest in the standard is appropriate.</p>	<p>Support noted.</p>
<p>Mr. Hirai did not support the relocation of the paragraph from the introduction to the objective, and emphasized the need for a concise objective.</p>	<p>Point not accepted.</p> <p>At the September 2020 meeting, the IAASB supported positioning the public interest paragraph with the objective. The IAASB also adjusted paragraph 12 of ISQM 1 to clarify that paragraph 14 of ISQM 1 is the objective of the standard.</p>
<p>Mr. Yurdakul noted that standards exist for the public interest, and therefore supported a statement about public interest in proposed ISQM 1. However, he indicated that the statement needs to be stronger and suggested explaining how the standard serves the public interest.</p>	<p>Point not accepted.</p> <p>The IAASB supported the explanation of public interest in paragraph 15 of ISQM 1. Paragraph 15 of ISQM 1 explains that the public interest is served by the consistent performance of quality engagements. It further explains how the system of quality management enables the performance of quality engagements, and how quality engagements are achieved.</p>
<p>Mr. Munter suggested that the objective should reflect a mindset of continual improvement that is embedded in the firm's culture. Ms. Zietsman highlighted that the notion of continual improvement and proactive management of quality is embedded in the robust risk-based approach to management of quality, which is an ongoing process that takes into</p>	<p>Point partially accepted.</p> <p>Ms. Corden agreed with Ms. Zietsman, noting that the notion of continual improvement is intertwined throughout the standard. She added that the material that will accompany the standard could possibly explain how this is the case.</p>

Representatives' Comments	ISQM 1 Task Force / IAASB Response
account the evolving nature of the firm and its environment, and the need for the firm to be nimble.	
Ms. Wei suggested that the public interest should be emphasized as part of the drafting conventions when setting standards.	<p>Point noted.</p> <p>The Complexity, Understandability, Scalability Proportionality Working Group is developing drafting principles and guidelines to enable the writing of standards that result in the consistent and effective application of the ISAs.</p>
Ms. Landell-Mills enquired about whether the Public Interest Oversight Board supported the location of paragraph 15 of proposed ISQM 1.	<p>Point noted.</p> <p>Mr. Kashiwagi indicated that the PIOB appreciated the ISQM 1 Task Force's efforts in addressing the issues related to the objective of the standard and external communications. He noted that the PIOB is supportive of the ISQM 1 Task Force's proposals.</p>
EXTERNAL COMMUNICATIONS	
Mr. Dalkin recalled the robust conversation that the CAG had related to external communications at the March 2020 CAG meeting. He reiterated that communication with those charged with governance could, in some cases, be in the form of a transparency report.	Point noted.
Ms. Manabat indicated her support for the proposals.	Support noted.
Mr. Thompson noted his support for the new requirement being directed at audits of listed entities, and added that it is a clear indication of the efforts made to address the scalability of the standard.	Support noted.
Ms. Zietsman recognized the ISQM 1 Task Force's efforts in addressing a challenging issue. She added that in her view, it would be more appropriate to address the issue at a national level, given the variance in expectations, requirements and customary practices across jurisdictions. As a result, she supported the principles-based requirements, rather than prescriptive requirements that could	Support noted.

Representatives' Comments	ISQM 1 Task Force / IAASB Response
result in boilerplate communications in some jurisdictions. Mr. Sobel also supported the approach and agreed that the requirements should be principles-based.	
Mr. Ruthman and Ms. Landell-Mills sought clarity on the intended purpose of the requirement and what it aims to achieve, for example, whether it is intended to assist with auditor selection or performance monitoring. They indicated that once it is determined what the purpose of the requirement is, it can then be established whether the requirement achieves that purpose, including whether it is appropriately aimed at audits of financial statements of listed entities and whether the proposed level of transparency is sufficient. Mr. Orth noted that the communication with those charged with governance serves multiple purposes.	<p>Point noted.</p> <p>Ms. Corden agreed that the purpose of the communication is multi-faceted.</p> <p>The IAASB supported requiring firms to have policies or procedures that require communication with those charged with governance when performing an audit of financial statements of listed entities about how the system of quality management supports the consistent performance of quality audit engagements. The IAASB's intended purpose and basis for this requirement is explained further in paragraphs 84–91 of the Basis for Conclusions.</p>
Ms. Landell-Mills indicated that more granular disclosure and transparency would be helpful and that for listed entities the proposed level of transparency could go further. Ms. Robert suggested that a balance is needed between the level of transparency and granularity, and the effectiveness of the communications, i.e., highly transparent and granular communication may be boilerplate and ineffective, while more high-level communication may be more effective.	<p>Points noted.</p> <p>Ms. Corden explained that the standard encourages external communication beyond transparency reports, by requiring the firm to have policies or procedures to address what other types of external communications may be appropriate, and the information to be provided.</p>
Mr. Yoshii inquired as to why paragraph A126 of proposed ISQM 1 distinguishes between information provided to those charged with governance and communications with external parties. He indicated that the information listed is relevant to all external parties.	The manner in which paragraph A126 of ISQM 1 is drafted applies to information provided to external parties, i.e., it is not limited to communications to those charged with governance.
Ms. Zietsman highlighted that the nature of the information to be communicated lends itself to a two-way conversation with those charged with governance, rather than formal written communication, and therefore suggested that the	<p>Point not accepted.</p> <p>The IAASB considered, but did not support, adding an emphasis that communication may be achieved through conversation. In particular, the IAASB noted that if information is important enough to be</p>

Representatives' Comments	ISQM 1 Task Force / IAASB Response
application material emphasize that the communication could be accomplished through a conversation.	communicated to those charged with governance, it would ordinarily be documented.
Mr. Sobel suggested that the standard address communication to those charged with governance about the firm's decisions related to the expertise assigned to perform the audit engagement.	ISQM 1 deals with communication to those charged with governance about the system of quality management. Communication to those charged with governance about specific matters related to the engagement and how the engagement has been performed are addressed in ISA 260 (Revised). ²
OTHER COMMENTS	
Mr. Thompson and Ms. McGeachy indicated that their concerns about the scalability of the standard have been abated, noting that the current draft is more scalable. Ms. McGeachy highlighted that the readability of the standard has improved.	Support noted.
Mr. Dalkin enquired about how proposed ISQM 1 has addressed component auditors.	Point noted. Ms. Corden explained that the definition of engagement team includes component auditors, and that proposed ISQM 1 needs to reflect how firms deal with the resources used on engagements, particularly given the recent proposals related to proposed ISA 600 (Revised). ³ She added that regardless of whether the component auditor is from within or outside the firm's network, the firm has a responsibility related to the resource. Ms. Corden clarified that the nature of the firm's responsibility and the policies or procedures designed by the firm to address the resources will vary based on factors such as where the member of the engagement team comes from, and how they are used on the engagement. She noted that ordinarily the evaluation of the competence and capabilities of the engagement team members is done at the

² ISA 260 (Revised), *Communication with Those Charged with Governance*

³ Proposed ISA 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

Representatives' Comments	ISQM 1 Task Force / IAASB Response
	engagement level, and that proposed ISQM 1 emphasizes the firm's responsibility to have a system of quality management to support the engagement team in performing the evaluation, and ensuring that there are sufficient appropriate resources to perform the engagement.
<p>Ms. Robert noted her concerns about including component auditors in the definition of engagement team, given that it increases the responsibility on the firm and engagement team for the component auditors. She explained that it could drive negative consequences on the audit market as firms may be more inclined to use network firms in performing audits, instead of non-network firms. She encouraged the IAASB to undertake an impact assessment of the proposals on the audit market. Mr. Cela and Mr. Pavas agreed with Ms. Robert's concerns.</p>	<p>Point not accepted.</p> <p>Ms. Corden noted that the ISQM 1 Task Force has coordinated with the ISA 600 Task Force, and the standard is therefore aligned with proposed ISA 600 (Revised). She explained that typically the evaluation of the competence and capabilities of the engagement team members is undertaken by the engagement partner at the engagement level. She also explained that current practice is for the firm to have a methodology based on the standards that sets out how the engagement partner is expected to evaluate the competence and capabilities of the engagement team members. Ms. Corden emphasized that there would unlikely be a change from current practice in terms of the competence and capabilities being evaluated at the engagement level. However, she highlighted that proposed ISQM 1 underscores the need for the firm to have a methodology in place (i.e., through their policies or procedures), in order to address any quality risks that arise in relation to the competence and capabilities of the engagement team members.</p>
<p>Ms. Zietsman supported Ms. Corden's explanation [with respect to component auditors being included in the definition of engagement team], and added that the focus needs to remain on the individuals performing the work, who may come from different sources. She emphasized how the structure of teams has evolved in recent years and that there are no longer clear distinctions between individuals working for the firm or outside the firm. As a result, she supported how the standard has addressed the issue with foundational principles. Ms. Zietsman also</p>	<p>Support noted.</p>

Representatives' Comments	ISQM 1 Task Force / IAASB Response
<p>noted that it is essential that the evaluation of the competence and capabilities of engagement team members rests with the engagement partner, in order to avoid any perception that the firm has primary responsibility for this matter. She noted that the firm's role is to support the engagement partner when the engagement team members are not competent and capable.</p>	
<p>Mr. Munter highlighted the need to have processes in place to manage resources from both within the firm's network and outside the network, and emphasized the need for the quality management standards and ISA 600 (Revised) to be aligned in this respect.</p>	<p>Point noted.</p> <p>Paragraph 32 of ISQM 1 requires the firm to have quality objectives addressing appropriately obtaining, developing, using, maintaining, allocating and assigning resources in a timely manner to enable the design, implementation and operation of the system of quality management. The resources contemplated in ISQM 1 include resources from networks and service providers that the firm uses in the system of quality management and performance of engagements.</p>

Appendix A

Project History

Project: [ISQM 1](#)

Summary

	IAASB CAG Meeting	IAASB Meeting
Project Commencement	March 2015 September 2015 September 2016	June 2014 (Quality Control only) December 2014 March 2015 June 2015 September 2015 December 2015 June 2016 September 2016
Project proposal	November 2016 Teleconference	December 2016
ISQC 1 issues discussion, including ISQC 2 addressing EQC reviews	March 2017 September 2017	December 2016 March 2017 June 2017 August 2017 September 2017
First Read of Draft Exposure Draft of Proposed ISQC 1		December 2017
Second Read of Draft Exposure Draft of Proposed ISQC 1	March 2018	March 2018
Third Read of Draft Exposure Draft of Proposed ISQC 1	September 2018	September 2018
Exposure Draft of ISQM 1 approved	March 2019 (Update and report back)	December 2018
Development of Final Standard	September 2019	September 2019

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IAASB CAG Discussions: Detailed References

Information Gathering: Responding to Calls to Enhance Audit Quality	<p><u>March 2015</u></p> <p>See IAASB CAG meeting material and CAG meeting minutes (Agenda Item B and C).</p> <p>http://www.ifac.org/meetings/new-york-usa-5</p> <p><u>September 2015</u></p> <p>See IAASB CAG meeting material and CAG meeting minutes (Agenda Item F).</p> <p>https://www.iaasb.org/cag/meetings/new-york-usa-5</p>
Information gathering: Overview of Responses to the ITC, Group Audits and Engagement Quality Control Reviews	<p><u>September 2016</u></p> <p>See IAASB CAG meeting material and CAG meeting minutes (Agenda Item G).</p> <p>http://www.iaasb.org/cag/meetings/new-york-usa</p>
Project Proposal	<p><u>November 2016</u></p> <p>See IAASB CAG meeting material and CAG meeting minutes (Agenda Item B).</p> <p>http://www.iaasb.org/cag/meetings/iaasb-cag-conference-call-november-29-2016-730-am-1030-am-est</p>
ISQC 1 Issues Discussion, Including EQC Reviews	<p><u>March 2017</u></p> <p>See IAASB CAG meeting material and CAG meeting minutes (Agenda Item H).</p> <p>http://www.iaasb.org/cag/meetings/iaasb-cag-meeting</p> <p><u>September 2017</u></p> <p>See IAASB CAG meeting material and CAG meeting minutes (Agenda Item D).</p> <p>http://www.iaasb.org/cag/meetings/iaasb-cag-meeting-madrid-spain</p> <p><u>March 2018</u></p> <p>See IAASB CAG meeting material and CAG meeting minutes (Agenda Item D).</p> <p>https://www.iaasb.org/cag/meetings/iaasb-cag-meeting-new-york-ny</p> <p><u>September 2018</u></p> <p>See IAASB CAG meeting material and CAG meeting minutes (Agenda Item C).</p>

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	https://www.iaasb.org/cag/meetings/iaasb-cag-meeting-new-york-ny-0
ISQM 1 Update and Report Back	<p><u>March 2019</u></p> <p>See IAASB CAG meeting material and CAG meeting minutes (Agenda Item H).</p> <p>https://www.iaasb.org/cag/meetings/iaasb-cag-meeting-new-york-ny-1</p>
ISQM 1 Development of Final Standard	<p><u>September 2019</u></p> <p>See IAASB CAG meeting material and CAG meeting minutes (Agenda Item C)</p> <p>https://www.iaasb.org/cag/meetings/iaasb-cag-meeting-new-york-ny-2</p> <p><u>March 2020</u></p> <p>See IAASB CAG meeting material and CAG meeting minutes (Agenda Item B)</p> <p>https://www.iaasb.org/cag/meetings/iaasb-cag-meeting-new-york-ny-3</p> <p><u>September 2020</u></p> <p>See IAASB CAG meeting material and CAG meeting minutes (Agenda Item B1)</p> <p>https://www.iaasb.org/cag/meetings/iaasb-cag-meeting-new-york</p>