

**Quality Management (Firm level): Documentation in ISQC 1<sup>1</sup>****Objective of the IAASB discussion**

The objective of this Agenda Item is to obtain the IAASB's input on the Quality Control Task Force's<sup>2</sup> (QCTF) proposals in relation to documentation. The input from the IAASB on this topic will assist the QCTF in further exploring the revisions to ISQC 1.

*As noted in the "Matters for IAASB Consideration" below, the IAASB is asked to provide the QCTF with input regarding the proposed documentation paragraphs in ISQC 1 (Revised), including whether they will result in appropriate documentation, whether the firm should be required to document certain processes, and whether there should be other specific documentation requirements.*

**Introduction**

1. In June 2017, the QCTF presented its recommendations on the proposed revisions to ISQC 1 in response to previous discussions with the IAASB and the CAG, as well as to further address responses to the Invitation to Comment (ITC).<sup>3</sup> The June 2017 recommendations included proposals relating to:
  - (a) Governance and leadership, including organization, culture and strategy;
  - (b) Information and communication (excluding documentation); and
  - (c) The quality management process (QMP), including monitoring and remediation.
2. The proposals of the QCTF were accompanied by a working draft of revised ISQC 1 (see [Agenda Item 2–B](#) of the June 2017 IAASB meeting) and the proposed prescribed quality objectives, quality risks, and responses that form part of the QMP (see [Agenda Item 2–C](#) of the June 2017 IAASB meeting).

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<sup>1</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*

<sup>2</sup> The QCTF comprises Karin French (Chair of the QCTF), Bob Dohrer, Brendan Murtagh, Imran Vanker, Josephine Jackson, Denise Weber, Keith Wilson (official observer) and Dawn McGeachy (correspondent member). The project page is available at: [Quality Control at Firm Level – ISQC 1](#).

<sup>3</sup> Invitation to Comment (ITC), *Enhancing Audit Quality: A Focus on Professional Skepticism, Quality Control and Group Audits*

## Background

3. This Issues Paper includes the QCTF's proposals in relation to the documentation requirements and application material that would be included in the revised ISQC 1. As previously presented to the IAASB, the documentation would form part of the component "information, communication and documentation", given the close relationship between these aspects of the system of quality management.

4. In the ITC, the topic of documentation was highlighted in relation to various aspects of audit quality, in particular professional skepticism, engagement quality control reviews and group audits. The ITC indicated that enhancing documentation of the auditor's judgment is a public interest issue, but did not include considerations relating to documentation of the firm's system of quality management. In general, respondents across all stakeholder groups supported more clarity regarding documentation in respect of professional skepticism, group audits and engagement quality control reviews. However, certain respondents cautioned against developing documentation requirements in these areas that are too burdensome, in particular for small- and medium-sized practitioners (SMPs).

5. While the proposals in the ITC about documentation did not specifically address the documentation of the firm's system of quality management, there were various comments from respondents raising concern regarding the implications of the proposed quality management approach on firms' documentation. On the one hand, it was indicated by a regulator that the documentation may be inadequate to support inspections by oversight authorities, and therefore clear documentation requirements would need to be established. In other cases, respondents across various stakeholder groups raised concern about the implications of introducing a quality management approach on firms' documentation. Nevertheless, respondents indicated support for clarity regarding what should be considered and documented by a firm as a basis for reliance on network policies or procedures at the firm level.



## Task Force Proposals

6. The QCTF is of the view that the documentation of the firm's system of quality management is important since:
- It facilitates a consistent and appropriate understanding and application of the firm's system of quality management, for example, through the documentation of the firm's policies or procedures that allows personnel to clearly understand their responsibilities.
  - In certain cases, it is a form of communication.
  - It provides evidence of the operation of the system of quality management for the purposes of internal monitoring activities, as well as external inspections by oversight bodies.

7. The QCTF recognizes the concerns from respondents to the ITC, including those representing the views of SMPs, that documentation requirements should not be overly burdensome. Nevertheless, the QCTF is of the view that the documentation requirements in extant ISQC 1 could be more specific in supporting consistent and appropriate documentation. Accordingly, the QCTF recommends that the documentation requirements in ISQC 1 be enhanced to provide clarity and facilitate consistent application.
8. In developing the requirements, the QCTF considered the principles contained in ISA 230,<sup>4</sup> in particular the principle that the documentation needs to be sufficient to enable an experienced auditor to understand the various matters relating to the audit described in paragraph 8 of ISA 230. The QCTF also considered how documentation is explained in the COSO Internal Control – Integrated Framework.<sup>5</sup> The QCTF is of the view that the requirements should relate to the objectives of the documentation, for example, those highlighted in paragraph 6 above. This is consistent with an outcome-based approach that allows a scalable application of the requirements.
9. Based on these considerations, the QCTF recommends the following in relation to the documentation requirements in ISQC 1:
  - (a) An overarching requirement should be developed that addresses the principles of documentation, similar to the approach in ISA 230, and takes into consideration the objectives of documentation in relation to a firm's system of quality management. The QCTF also suggests that there should be a clear articulation of the expectation that the firm should document matters related to the design and operation of the system of quality management. (see **paragraph X1(a) and 1(b)** of the proposed requirements below). In this regard, the QCTF also debated whether firms should document matters related to the firm's processes in relation to the system of quality management, for example, the process for establishing the quality objectives and identifying and assessing quality risks. With the exception of one member (see below), the QCTF agreed that it would not be necessary to prescribe such documentation since in some circumstances, documentation of the quality objectives, risks and responses may be sufficient for a consistent understanding of the firm's system of quality management. However, the QCTF is of the view that the standard should note in the application material that in some circumstances documentation may include matters related to the process (see **paragraph AX5** of the proposed application material below).
  - (b) More specific documentation requirements in relation to the components of the firm's system of quality management should be developed that are necessary in order for the firm to achieve the objective of documentation established in the overarching requirement described above, and support the consistent application of the requirement (see **paragraph X2** of the proposed requirements). With the exception of one member, the QCTF is of the view that given the nature of certain components, flexibility is necessary in relation to the documentation of matters related to such components, and therefore the requirements should address documentation in relation to only certain components. For those components not addressed in the requirements, the QCTF recommend the inclusion of application material that explains the type of documentation that may be appropriate in relation to such components (see **paragraph AX3–AX4** of the proposed application material).

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<sup>4</sup> ISA 230, Audit Documentation

<sup>5</sup> Committee of Sponsoring Organizations of the Treadway Commission (COSO), Internal Control – Integrated Framework

10. As indicated in paragraph 9 above, one member of the QCTF did not agree with the QCTF proposals. This member is of the view that (i) the firm should be required to document matters related to the firm's processes in relation to the system of quality management; and (ii) specific documentation requirements should be established in relation to all of the components.<sup>6</sup> In addition to noting paragraphs 102 and 103 of Appendix 2 of the Audit Quality Framework,<sup>7</sup> this member is of the view that the various components of the system of quality management operate together, thereby creating a need for a documentation trail that supports the system.

## Proposed Requirements and Application Material

11. The proposed requirements and application material are as follows:

### Requirements

#### Documentation

- X1. The firm shall document matters related to its system of quality management that: (Ref: Para. AX1–AX4)
- (a) Is sufficient to support a consistent understanding and application of the components of the firm's system of quality management by engagement teams and personnel performing functions in relation to the operation of the firm's system of quality management, including an understanding of roles and responsibilities with respect to the firm's system of quality management; and
  - (b) Provides evidence of the operation of each component of the firm's system of quality management, including evidence to support the firm's evaluation of its system of quality management. (Ref: Para. AX5)
- X2. The documentation shall include:
- (a) The firm's quality objectives and quality risks;
  - (b) A description of how the firm's responses address the firm's quality risks; (Ref: Para. AX6)
  - (c) When relevant, the results of periodic performance evaluations, as contemplated by paragraph 25 [of the Working Draft of ISQC 1 presented to the IAASB in June 2017], including the firm's corrective actions to address performance issues that are identified from such performance evaluations; and
  - (d) Evidence of monitoring activities performed, the results of the monitoring activities, identified root cause(s) and remedial actions to address root cause(s). (Ref: Para. AX7)

<sup>6</sup> This member suggested that an additional requirement should be added to paragraph 2 of the proposed drafting that indicates "Evidence of communication of appropriate information necessary to enable and support the proper functioning of the firm's system of quality management". This member indicated a requirement could be established in relation to documentation of matters regarding governance and leadership that contains aspects of the application material in paragraph A4.

<sup>7</sup> A Framework for Audit Quality: Key Elements that Create an Environment for Audit Quality

- X3. The firm shall establish a period of time for the retention of documentation in relation to the system of quality management that is in accordance with law, regulation or professional standards, if applicable, and that is sufficient to:
- (a) Permit those performing monitoring procedures to evaluate the firm's system of quality management; and
  - (b) Support the maintenance of the firm's system of quality management.

### **Application Material**

Documentation (Ref: Para. X1–X3)

AX1. Documentation also provides evidence that the firm complies with this standard and law, regulation or relevant ethical requirements and may be useful for training new personnel and ensuring the retention of organizational knowledge. It is neither necessary nor practicable for the firm to document every matter considered, or judgment made, in relation to its system of quality management. Furthermore, compliance with this standard may be evidenced by the firm through documents or other written materials that are integral to the components of the system of quality management, for example, a written confirmation from firm personnel regarding compliance with the firm's policies or procedures in relation to independence.

AX2. The form, content and extent of documentation of matters related to the firm's system of quality management is a matter of judgment and depends on a number of factors, including the following:

- The size of the firm and the number of offices;
- The nature and complexity of the firm's practice and organization;
- The types of services the firm provides and the nature of the clients to whom services are provided; and
- The expectations of external oversight authorities.

For example, it may not be necessary to have documentation supporting the communication of matters in a smaller firm, since informal communication methods may be effective. In the case of a larger firm, the use of electronic databases and information technology to support the documentation of matters related to the system of quality management may be appropriate given the volume and geographical dispersion of such firms (e.g., independence confirmations, performance evaluations and the results of monitoring). However, smaller firms may use manual methods in order to document matters related to their system of quality management, such as notes, checklists and forms.

AX3. Paragraph A44 [of the Working Draft of ISQC 1 presented to the IAASB in June 2017] explains that there are a variety of methods the firm may use to communicate information, which may include documented forms of communication. Information necessary to enable and support the proper functioning of the firm's system of quality management may also be in documented form.

AX4. Documentation that demonstrates the firm's governance and leadership and matters related to the firm's culture may include documentation of how the responsibilities within the firm are

assigned. Documentation that provides evidence of the implementation of the governance principles may comprise documentation in relation to other areas of the firm's system of quality management, for example, the documentation of the firm's quality objectives, quality risks and responses. The actions of firm leadership also provide evidence of the firm's governance that may be documented in a variety of ways, for example, consultations, minutes of meetings or communications from firm leadership.

AX5. In some circumstances, it may be appropriate for the firm to document its process and analyses for establishing the quality objectives, identifying and assessing quality risks and designing responses to such risks. For example, a larger firm may have multiple personnel that may participate in the firm's process for establishing the quality objectives, identifying and assessing quality risks and designing responses to such risks, and documentation of how the firm's process operates may be needed to support a consistent understanding and application of the firm's process.

AX6. A description of how the firm's responses address the firm's quality risks may comprise a description of the response to the risk (e.g., the firm's documentation of its policies or procedures), or may include other forms of documentation (e.g., a process flowchart).

AX7. Appropriate documentation relating to monitoring and remediation may also include:

- The procedures for selecting completed engagements to be inspected;
- The firm's response in circumstances when a deficiency identified relates to an engagement and there is an indication that the report may be inappropriate or that procedures were omitted during the performance of the engagement; or
- A record of the evaluation of:
  - Adherence to professional standards and applicable legal and regulatory requirements;
  - Whether the firm's quality objectives are relevant, whether all quality risks have been identified and appropriately assessed and whether the responses to quality risks remain appropriate; and
  - Whether the firm's system of quality management provides the firm with reasonable assurance that its overall objective has been achieved.

**Matter for IAASB Consideration**

1. The IAASB is asked to share their views regarding the proposed requirements and application material addressing documentation that would be incorporated in the draft of ISQC 1 (Revised), including:
  - a) Whether the proposed requirements clearly set out how firms are expected to document matters related to the system of quality management and whether the documentation requirements would result in appropriate documentation.
  - b) Whether the documentation requirements should require the firm to document the processes relating to the system of quality management, including the firm's processes for establishing quality objectives, identifying and assessing quality risks and designing and implementing responses to the quality risks.
  - c) Whether there should be specific documentation requirements in relation to all components of the system of quality management.

**QCTF Activities Including Outreach and Coordination with Other IAASB Task Forces and Working Groups**

1. The following sets out the activities of the QCTF including outreach with others and coordination with other IAASB Task Forces and Working Groups relating to the quality control project.

**Task Force Activities Since Last IAASB Discussion**

2. Since the June 2017 IAASB meeting, the QCTF has met once in person and held one teleconference. The Drafting Team of the QCTF will also hold an in-person meeting before the September 2017 IAASB meeting.

**Outreach**

3. A two-day workshop will be held in London with representatives of the Global Public Policy Committee (GPPC) before the September 2017 IAASB meeting. This meeting will also be observed by representatives of the International Forum of Independent Audit Regulators Standards Coordination Working Group, as well as a Public Interest Oversight Board Observer. The purpose of this workshop is to discuss the proposals of the QCTF that were presented to the IAASB in June 2017 and on the August 2017 teleconference, and to obtain views from the GPPC representatives about the practical implications of the proposals.
4. The IAASB will also be hosting a webcast on September 21<sup>st</sup>, 2017 on quality control that will be led by the Chair of the QCTF. The audience of the webinar will largely comprise small and medium sized practitioners.

**Coordination with Other IAASB Task Forces and Working Groups**

5. The Chair of the ISA 220<sup>8</sup> Task Force and IAASB Staff supporting this project attended the QCTF's in-person meeting. The IAASB Staff supporting the quality control project also attended portions of the ISA 220 Task Force's in-person meeting, particularly the discussions regarding how the elements and principles of the quality management approach would cascade into ISA 220. Furthermore, the Chairs of the QCTF and ISA 220 Task Force and IAASB Staff held a teleconference to discuss how coordination should be undertaken between the Task Forces in the next quarter.

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<sup>8</sup> ISA 220, *Quality Control for an Audit of Financial Statements*