



## Quality Management (Firm Level)

Karin French, Chair of the Quality Control Task Force

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Agenda Item D

September 11, 2017

IAASB

International Auditing  
and Assurance  
Standards Board

## Relevant Public Interest Issues Identified in the ITC

- **Keeping ISQC 1 and ISA 220 fit for purpose**
  - More **complex and varying environments**, e.g., use of ADMs and firm structures
  - **Robust, yet sufficiently flexible**, requirements and guidance to drive appropriate management of quality
- Encouraging **proactive quality management** at the firm and engagement level
  - **Preventative, ongoing approach** to quality management, that encourages a **commitment to quality**
  - Improving recognition of **external stakeholders**, to improve the firm's recognition of its **public interest role**

## Relevant Public Interest Issues Identified in the ITC (cont.)

- **Transparency**
  - Encouraging **effective communication** with external stakeholders
  - **Greater insights** into how a firm manages quality
- Enhancing firms' **internal and external monitoring and remediation** activities
  - Improving the understanding of the **causes of deficiencies**
- Reinforcing the need for **robust two-way communication**

# Overview of ISQC 1

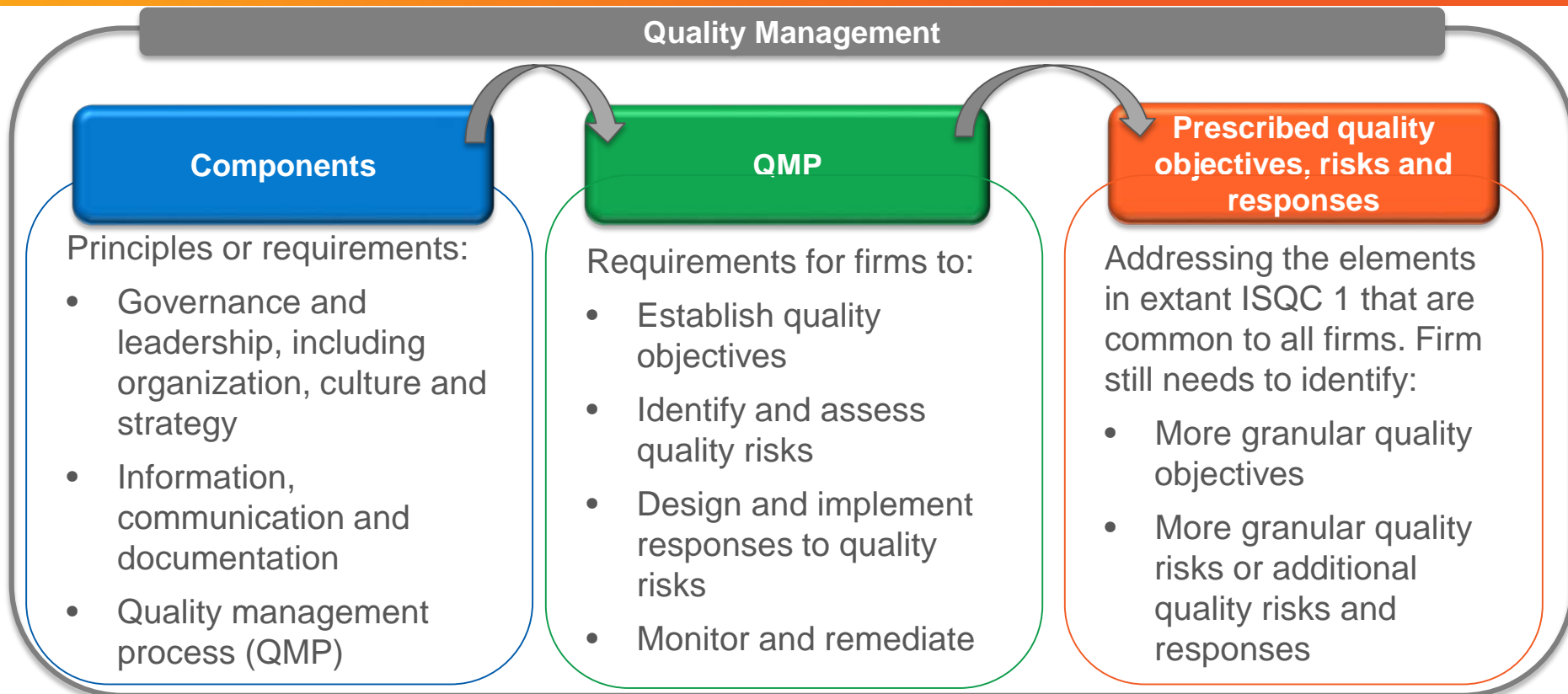
## Quality Management Approach



A modernized, fresh approach to firms' management of quality:

- Risk-based
- Effective
- Proactive and preventative
- Tailored for the firm's circumstances

# Components of ISQC 1



## IAASB's General Feedback on QCTF Proposals

- **General support** for direction proposed by QCTF
- Need to further consider **scalability and length** of standard
- **Outreach very important** to developing ED and obtaining input on practicality of proposals
- Explore the development of **accompanying guidance**

## Consideration of Networks at the Firm and Engagement Level





## Consideration of Networks at the Firm Level

- **Definition of a network or network firm** to remain the same as extant (consistent with IESBA definition)
- **No requirements** for the **networks** themselves
- Strengthened requirements and/or application material in relation to firm
  - **Proactive two-way communication** on a timely basis and as needed
    - Clarify the types of **information** that should be communicated between network / firms / engagement teams, including component auditors
  - **More proactively consider** relevant aspects of the network's system of quality management
    - **Further consideration** by QCTF **needed** as to how this will be developed, for example:
      - Monitoring activities undertaken at a network level
      - How networks affects the firm's identification and assessment of quality risks and design of responses to quality risks

## Consideration of ADMs at the Firm Level

- **Firm's responsibilities** in relation to **ADMs**
  - Further consideration by QCTF needed
  - Flexible in order to reflect variety of circumstances in how ADMs are established

# **Governance and Leadership, Organization, Culture and Strategy**

# System of Quality Management: Governance and Leadership



## Introducing Governance Principles

- New requirement for firm to establish governance principles
  - Establishes the “environment” for the system of quality management
  - Principles applicable to all firms, but scalable for the circumstances
  - Firm’s public interest role addressed through various principles, including consideration of stakeholders
  - Enhancements to the culture of the firm, and extending the culture throughout the firm (i.e., “tone in the middle”)
- Firm required to implement governance principles through actions
  - Actions may comprise other aspects of the system of quality management, e.g., communication, responses to quality risks

## Enhancing Leadership's Responsibilities

- Overall responsibility of firm leadership – quality or the system? – still to be determined
- Governance principles echoed in leadership responsibilities – clarifies and emphasizes leadership's role in relation to each principle
- Enhancement regarding the necessary attributes of firm leadership, i.e., sufficient and appropriate experience, knowledge and capacity
- New responsibility for firm's resources
  - Resources expanded beyond human resources to include technological, financial and intellectual resources
- New requirement addressing performance evaluations of leadership and those responsible for the system of quality management
  - Firm required to address the “outcome” of performance evaluations that links to monitoring and remediation

## Questions: Governance and Leadership, Organization, Culture and Strategy

4. Representatives are asked to share their views in relation to the requirements addressing governance and leadership, in particular:
  - (a) How the requirements address the culture of the firm and the responsibility of all firm personnel for quality.
  - (b) Whether the requirements appropriately address the firm's public interest role.
  - (c) The responsibilities of firm leadership in paragraph 24, in particular whether firm leadership is responsible for quality overall, or only the system of quality management.
  - (d) The proposed new requirement in paragraph 26 addressing performance evaluations.

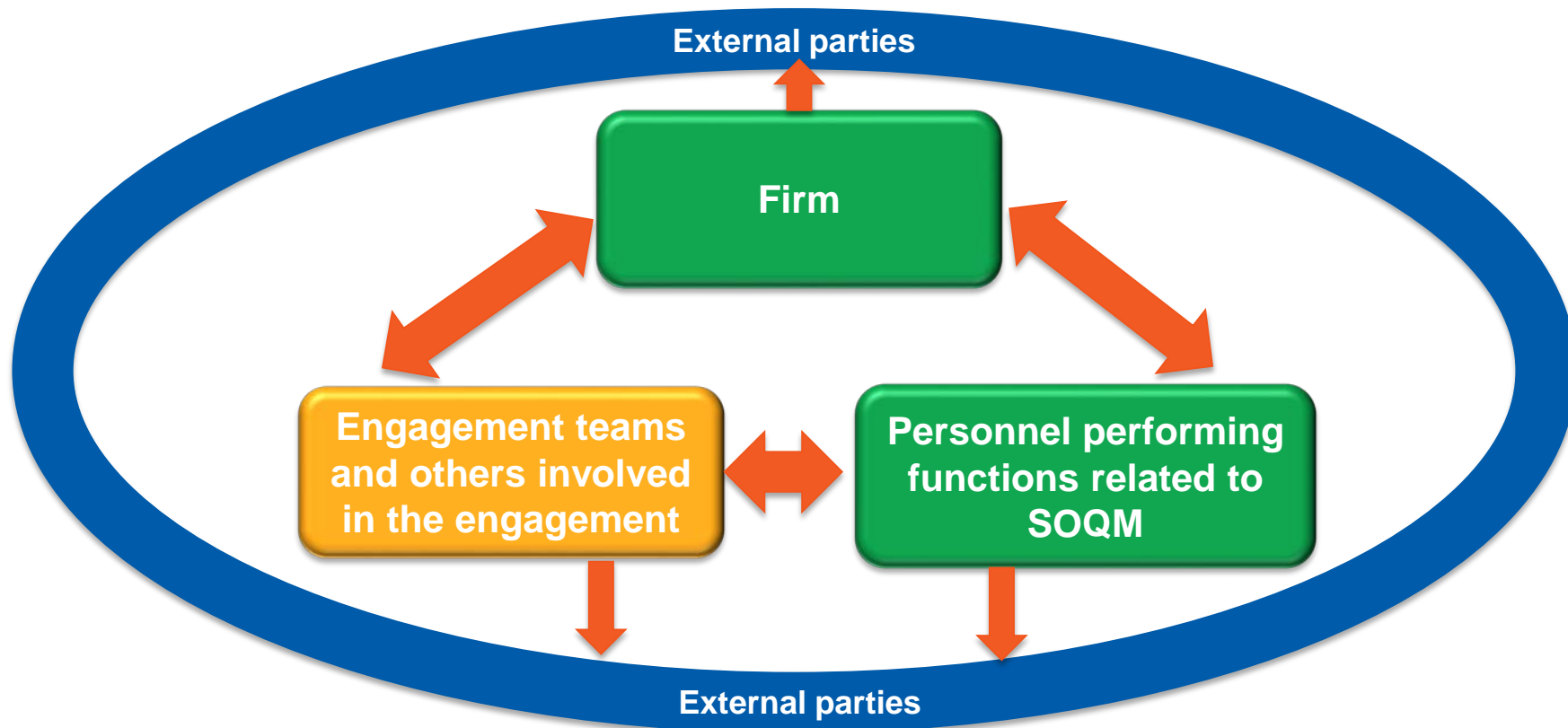
# Information and Communication



# Information, Communication and Documentation



## Enhancing Two-Way Communication and Addressing Information Needs



## IAASB's Feedback to be Further Considered

- Proposals high-level, **more granularity needed**
- **Two-way nature of communication** needs more emphasis
- Further **coordination with ISA 220 TF**
- **Documentation** proposals to be discussed with IAASB September 2017

## Documentation: Proposals to be Presented to the IAASB

- 2 “layers” of requirements:
  - Overarching, outcome-based requirement to reflect “objective” of documentation and to address both the “design” and “operation” of the system
    - Consistent and appropriate understanding and application of the firm’s system of quality management (i.e., design),
    - Evidence of the operation of the system of quality management to support the firm’s evaluation of its system of quality management (i.e., operation)
  - Specific documentation requirement related to certain components, that support overarching requirement, and consistent application
    - Quality objectives and risks, and description of how responses address risks
    - Results of periodic performance evaluations and corrective actions
    - Evidence and results of monitoring activities, identified root cause(s) and remedial actions

# Quality Management Process

## Quality Management Process



**Establish objectives**

**Identify and assess  
quality risks**

**Design and implement  
responses**

## Extant ISQC 1 – “Silo” Approach by Element

### Relevant ethical requirements

- Policies and procedures on independence
- Annual independence confirmation
- Rotation of engagement partner and EQC reviewer

### Acceptance and continuance

- Policies and procedures on capabilities to perform engagements
- Policies and procedures on client integrity

### Human resources

- Policies and procedures on sufficient, competent, ethical personnel
- Policies and procedures on assignment of engagement partner and teams

### Engagement performance

- Policies and procedures to perform in accordance with professional standards
- Policies and procedures on direction, supervision and review, consultation, EQC review

The above representation of the elements of extant ISQC 1 is for illustrative purposes and may not include all aspects within the various elements

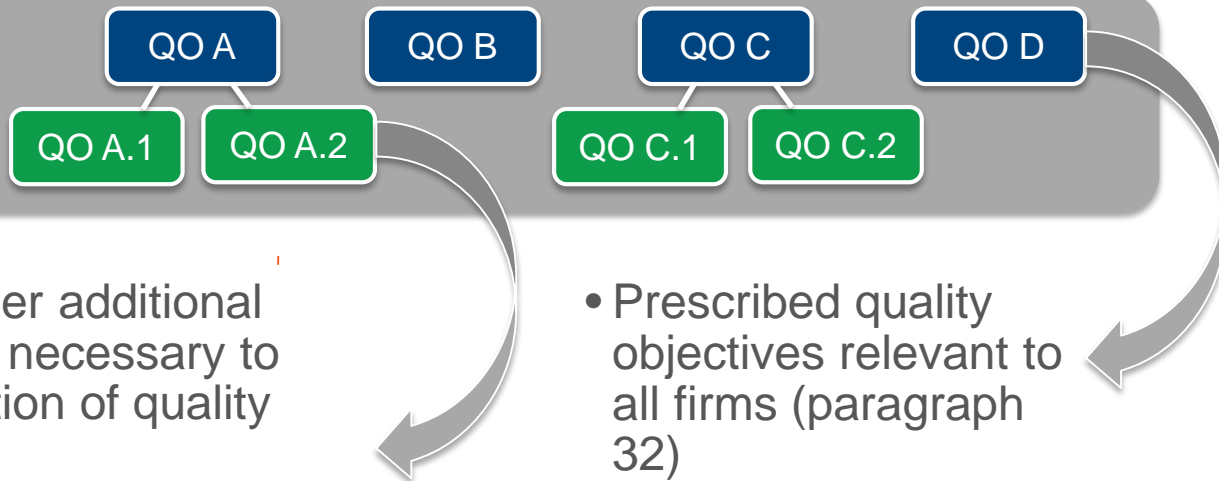
## Quality Management Process: A Tailored, Integrated Approach

- Firm establishes quality objectives, identifies and assesses quality risks and designs and implements responses according to **circumstances of the firm and nature of engagements** it performs
- Categorization according to “elements” – instead reflected in **prescribed quality objectives**
  - High **interrelationship and connectivity between** quality objectives, quality risks and responses
- **Prescribed quality risks** applicable to all firms
  - Developed from **requirements in extant ISQC 1** - level of **specificity / granularity** adjusted for consistency and appropriateness
  - Certain requirements in extant ISQC 1 to be included in **prescribed responses** (e.g., **EQC reviews for audits of listed entities**)



## Quality Management Process: A Tailored, Integrated Approach

### Establish quality objectives

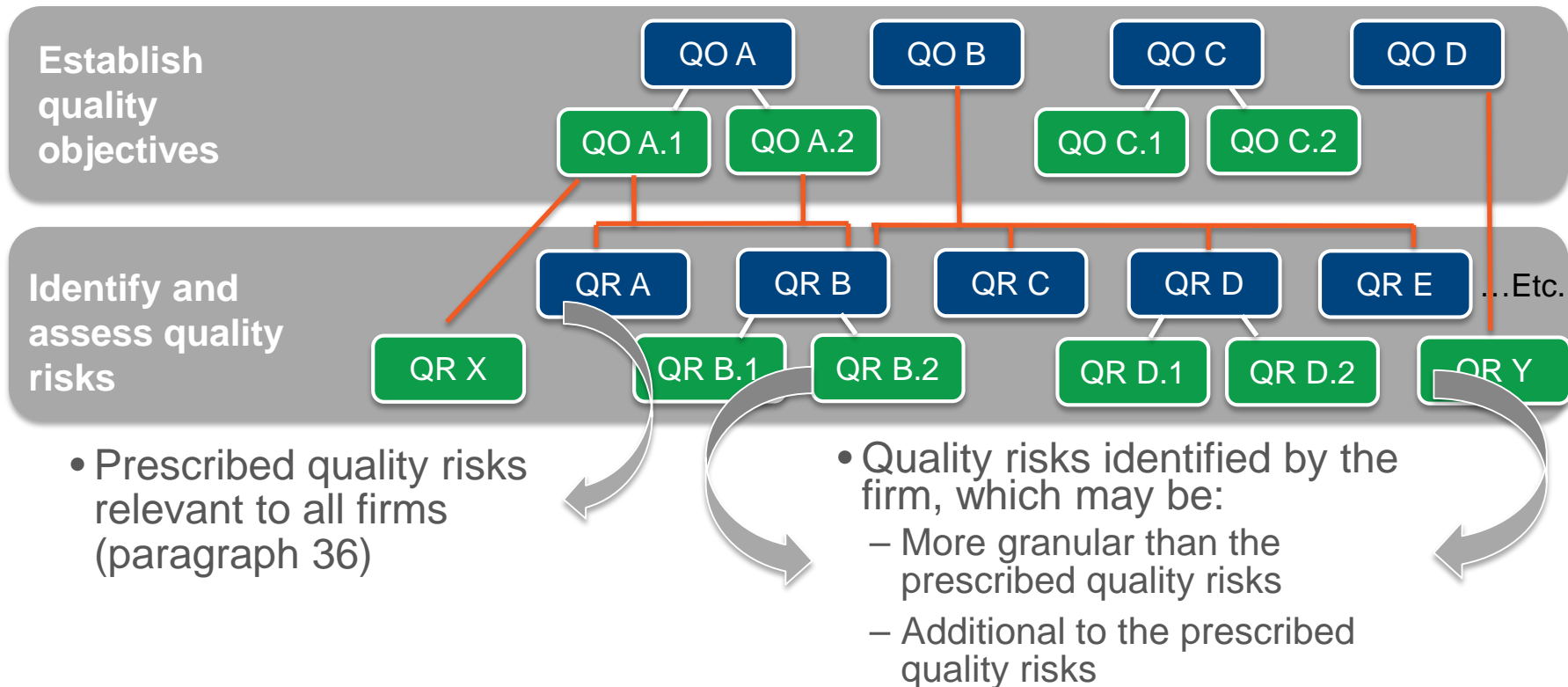


- Firm considers whether additional quality objectives are necessary to support the identification of quality risks
  - Based on firm's circumstances and nature of engagements
  - Prescribed quality objectives at a more granular level

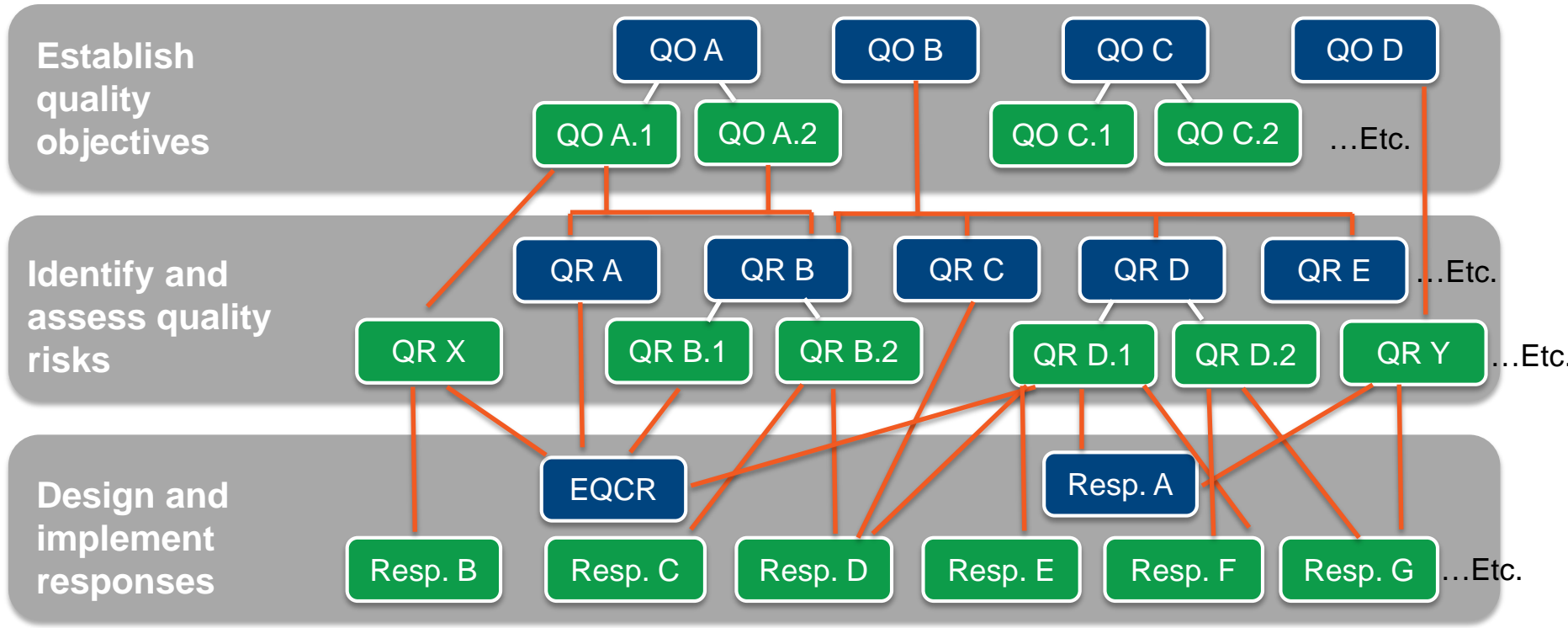
- Prescribed quality objectives relevant to all firms (paragraph 32)

NOTE: How a firm designs the quality objectives, quality risks and response may vary, e.g., a firm may have quality objectives for engagement types or types of entity for whom engagements are performed (e.g., listed)

## Quality Management Process: A Tailored, Integrated Approach (cont.)



# Quality Management Process: A Tailored, Integrated Approach (cont.)



## IAASB's Feedback to be Further Considered

- **Refinement needed** (particularly prescribed quality risks)
  - Generally level of **specificity is appropriate**
  - Need to **explore resources** (human, technological, financial, intellectual)
- **Explore prescribed responses**
  - **EQC reviews** one of prescribed responses – are there more?
- **How to establish a “threshold” for quality risks**
  - Further explore developing threshold and relationship with “reasonable assurance” and “deficiencies”
- **Clarify and enhance linkage with ISA 220**

## Questions: Quality Management Process

5. Representatives are asked to share their views in relation to the requirements addressing quality objectives, quality risks and responses, in particular:
  - (a) Whether the proposals would improve firms' systems of quality management, i.e., a more robust, tailored and effective system of quality management.
  - (b) Whether the proposed level of specificity in relation to the quality objectives (para. 32) and quality risks (para. 36) are appropriate, given that the quality risks have been generated from the requirements in paragraphs 20–34 and 43–47 in extant ISQC 1.

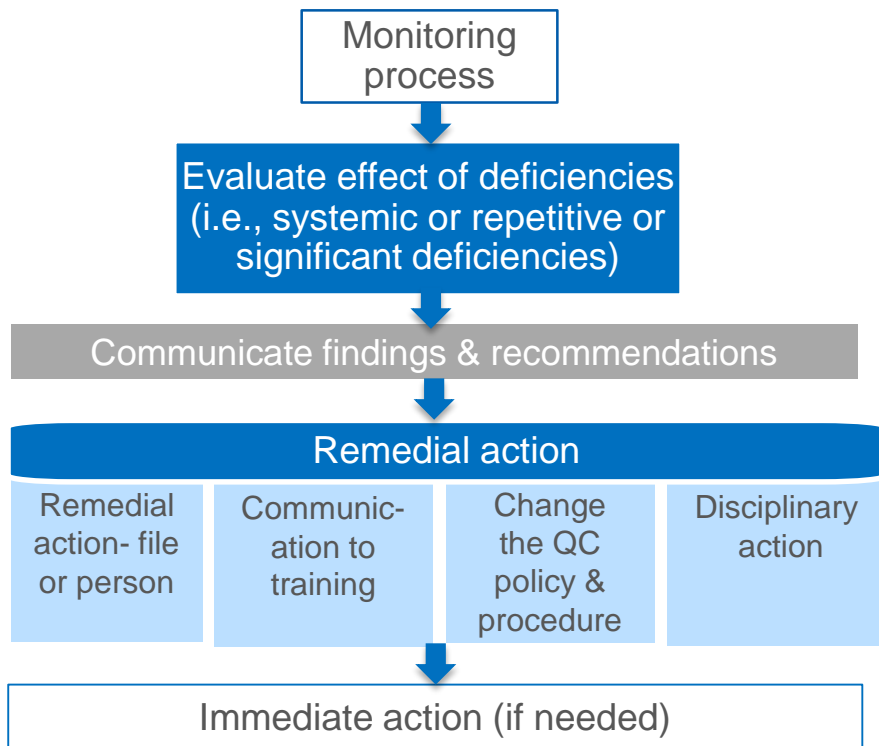
# Monitoring and Remediation

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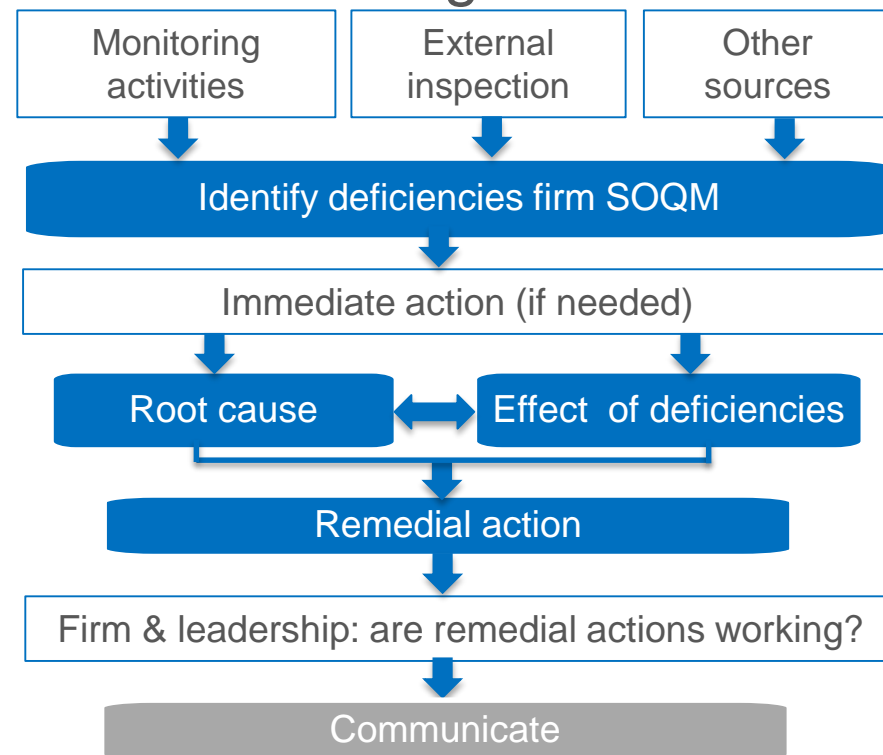


# The Monitoring and Remediation Process

## Extant



## Working Draft





## Enhancing Monitoring and Remediation

- **Key enhancements** from extant ISQC 1:
  - Emphasis on **monitoring the system as a whole**, rather than focus on engagement inspections
  - Increased focus on **tailoring the scope and frequency of monitoring activities** to the circumstances of the firm
    - Promotes **scalable, risk-based** approach to monitoring
  - Engagement inspections retained
    - New emphasis on **sufficiency of engagement inspections** based on the objective of monitoring
  - **Eligibility of those performing monitoring activities** enhanced
    - Additional **attributes** (experience, knowledge capacity and objectivity)
    - Applies to **all monitoring activities** (i.e., not only engagement inspections)

## Enhancing Monitoring and Remediation (cont.)

- **Key enhancements** from extant ISQC 1 (cont.):
  - Increased “**scope**” of **information sources** for identifying deficiencies
    - Linkage with other aspects of system of quality management
  - Requirement to **investigate root cause of deficiencies and evaluate effect**
    - Reconsider quality risks and responses - emphasizes **continual improvement**
  - Prescriptive remedial actions removed
    - **Appropriate remedial actions** determined by the firm
  - **Firm leadership responsibility** to monitor **effectiveness of remedial actions**

## IAASB's Feedback to be Further Considered

- Further refinements to the **objective of monitoring**
- Further **explore root cause analysis**, including:
  - Better **differentiation of deviations** (isolated etc.) **versus deficiencies** (more systemic) – helps drive extent of understanding root cause
  - More emphasis on “**engagements that went well**”
- Incorporation of **networks**

## Questions: Monitoring and Remediation

6. Representatives are asked to share their views in relation to the requirements addressing monitoring and remediation, including:
  - (a) Whether the proposals sufficiently address the current regulatory landscape, in particular the expectations of regulators and oversight bodies with respect to firms' monitoring and remediation.
  - (b) Matters relating to firm's inspections of engagements, set out in paragraph 42.

## General Questions

1. Are Representatives of the view that the proposed working draft of ISQC 1 (Revised) is a robust and improved standard that facilitates scalable application for firms of varying size and complexity?
2. Are Representatives of the view that the proposed standard would result in a more robust and effective system of quality management for firms?
3. Are Representatives concerned that the proposed changes could result in a disproportionate burden on smaller firms?

# Next Steps

## EQC Review – Separate Standard

- IAASB agreed requirements addressing EQC reviews should be located in **separate standard**:
  - Emphasizes **scalability**, i.e., applicable only if there are engagements within the firm that qualify
  - **Requirements are different** than other requirements in revised ISQC 1
  - More **clarity** that the firm **may have multiple responses**
    - The firm may identify other responses in addition to the EQC review, or that are more appropriate if an EQC review is not required to be performed
  - **Increases prominence** and emphasizes importance
  - More **streamlined** (repetitive requirements under extant ISQC 1 and ISA 220)

**ISQC 1 (Revised)**  
Requirement on the  
selection of  
engagements for EQC  
review



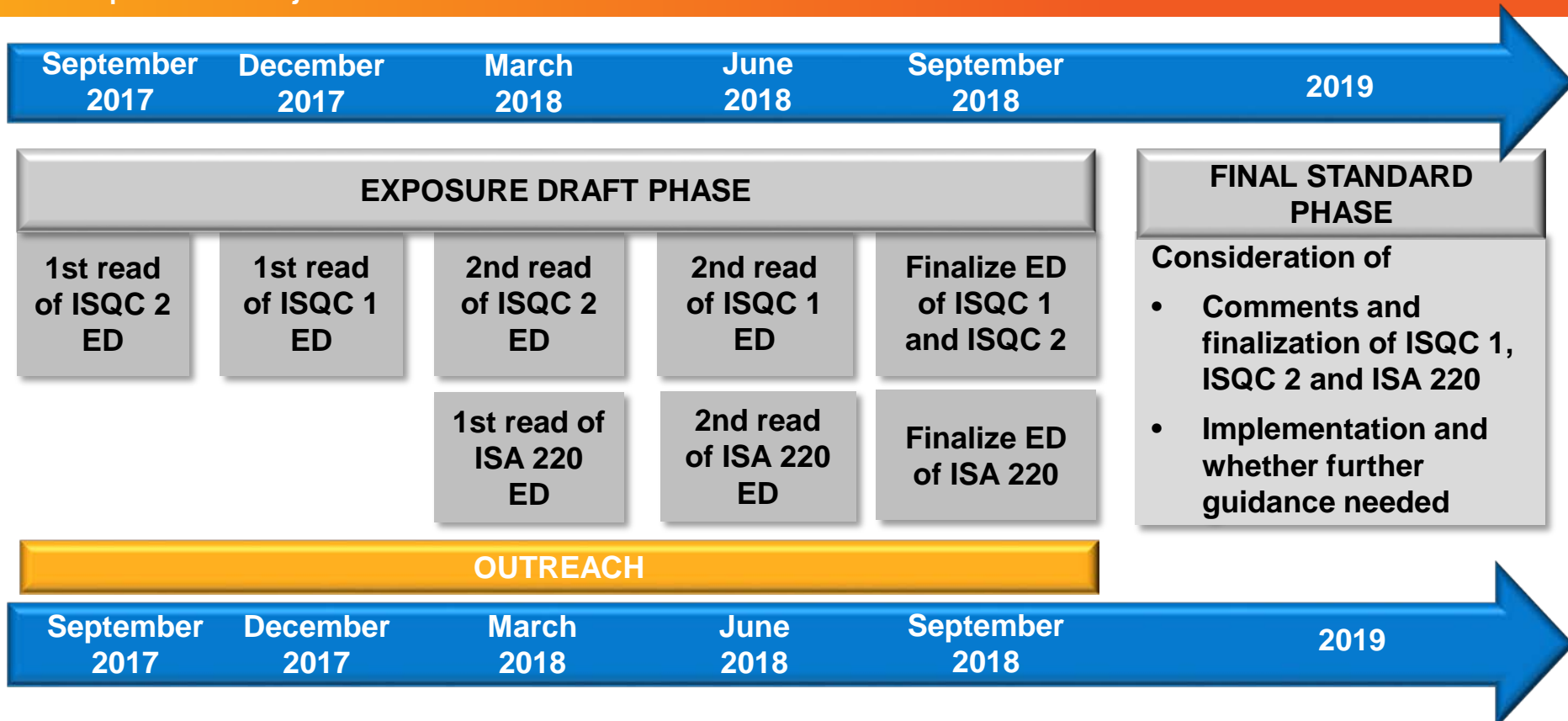
**ISQC 2 (New)**  
All other requirements  
in relation to EQC  
reviews, including  
responsibilities of the  
firm and the EQC  
reviewer

## Areas Still to be Explored

- Further exploration and refinement of proposals already presented to address IAASB comments
- Consider the scalability and length of the standard, in particular application material
- Documentation – discussion with IAASB September 2017
- Other areas still to be developed
  - Engagement partner performance and rewards, competency and human resources
  - Transparency reporting
  - Impact on other IAASB Standards (e.g., ISRE 2400 (Revised) and ISAE 3000)
  - Consideration of the impact of the IESBA's projects, e.g., safeguards



## Proposed Project Timeline





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