

This Draft Exposure Draft of ISQC 1 includes all guidance which the Quality Control Task Force (QCTF) considers useful in supporting an understanding of the proposed requirements. The QCTF recognize that certain guidance may not be necessary for the application of the standard and may be better placed in a separate publication. These paragraphs are marked in “grey text” in this Agenda Item. **Agenda Item 6** further explains the effect on the length of the Draft Exposure Draft if such paragraphs were to be located elsewhere.

**DRAFT EXPOSURE DRAFT OF INTERNATIONAL STANDARD ON QUALITY
CONTROL 1 (REVISED) – FIRST READ**

**QUALITY MANAGEMENT FOR FIRMS THAT PERFORM AUDITS OR REVIEWS OF
FINANCIAL STATEMENTS, OR OTHER ASSURANCE OR RELATED SERVICES
ENGAGEMENTS**

(Effective as of December 15, 20XX)

[CONTENTS PAGE TO BE INSERTED]

Introduction

Scope of this ISQC

1. This International Standard on Quality Control (ISQC) deals with a firm’s responsibilities for its system of quality management and applies to all firms of professional accountants who perform audits or reviews of financial statements, or other assurance or related services engagements. This ISQC sets forth requirements and guidance for the design, implementation and operation of the firm’s system of quality management.
2. Other pronouncements of the International Auditing and Assurance Standards Board (IAASB) set out additional standards and guidance on the responsibilities of firm personnel regarding quality management for specific types of engagements. ISA 220,¹ for example, deals with quality management for audits of financial statements. Law, regulation or relevant ethical requirements may also establish additional responsibilities for the firm in relation to quality management beyond those described in this ISQC. (Ref. Para. A1)

The Firm’s System of Quality Management

3. The objective of the system of quality management is to provide the firm with reasonable assurance that: (Ref. Para A2)
 - (a) The firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements and conduct engagements in accordance with such standards and requirements; and
 - (b) Reports issued in relation to engagements by the firm or engagement partners are appropriate in the circumstances.

¹ International Standard on Auditing (ISA) 220, *Quality Control for an Audit of Financial Statements*

4. The firm establishes its system of quality management and maintains it through evaluating and updating the system as a result of changes in the firm's circumstances and to address deficiencies in the system identified through the firm's monitoring activities or other information. A firm's system of quality management comprises the following eight components:
- (a) The quality management process;
 - (b) Governance and leadership;
 - (c) Information and communication;
 - (d) Relevant ethical requirements;
 - (e) Acceptance and continuance of client relationships and specific engagements;
 - (f) Resources;
 - (g) Engagement performance; and
 - (h) The monitoring and remediation process.

The appropriate operation of these components in an integrated manner forms the system of quality management, and they collectively reduce, to an acceptably low level, the risk of the system not achieving its objective. This ISQC includes an objective in relation to each of these components that sets forth what needs to be achieved for each component in order that the objective of the system is met. (Ref. Para A3–A5)

5. The quality management process allows the firm to tailor the system of quality management to the circumstances of the firm, through:
- (a) Establishing quality objectives that support the achievement of the component objectives set forth in the standard and are specific to the firm;
 - (b) Identifying the risks that, individually or in combination, may adversely affect the achievement of the firm's quality objectives; and
 - (c) Designing and implementing responses that reduce the quality risks to an acceptably low level, and promote the effective use of the firm's resources and the effective management of quality.

Factors that may affect the firm's system of quality management include, for example, the size and operating characteristics of the firm, the extent to which the firm utilizes services provided by a network, the types of services the firm provides, the industries in which it operates, or the nature of the entities to which those services are provided. The quality management process is applied to all components, except for the monitoring and remediation process.

6. This ISQC sets forth an objective for each component, and for certain components, the firm is required to establish quality objectives that need to be achieved in order that the component objective is met. The firm may identify more granular, or additional, quality objectives relevant to the firm's circumstances that support the identification and assessment of its quality risks. The firm identifies quality risks in relation to the quality objectives, through understanding the conditions, events, circumstances, actions or inactions relevant to the firm that could have an adverse impact on the firm's ability to achieve its quality objectives. Based on the assessment of the identified quality risks,

the firm designs and implements responses to address the quality risks identified by the firm, that include the required responses set out in this ISQC.

7. Quality management is a continual, dynamic process that involves an ongoing consideration of the relevance and appropriateness of the firm's system of quality management. Changes in the circumstances affecting the firm (e.g., the types of services the firm provides or the nature of the entities to which those services are provided) or other information (e.g., the results of the firm's monitoring activities or information received through the firm's complaints and allegations) may indicate the need for the firm to consider the appropriateness of its system of quality management and modify it, as necessary.

Considerations in Relation to the Size and Complexity of the Firm

8. The components of the firm's system of quality management, including the component objectives, quality objectives and required responses, are applicable to all firms. How the firm establishes its system of quality management in accordance with the requirements of this standard may vary depending on various factors, including the size and complexity of the firm. For example:
 - (a) The firm may have a simple organizational structure such that the process for assigning responsibility and accountability is less complex. A larger firm may have more complex leadership structures with designation of responsibility across various personnel. In a smaller firm, promoting the firm's culture may largely be achieved through firm leadership's behavior in daily interactions and decision-making activities, due to the close and frequent interaction between firm leadership and personnel. In a larger firm, in addition to the behaviors of firm leadership to instill the firm's culture, more extensive actions may be required to embed such culture throughout the firm. Furthermore, the extent to which the firm's strategic decisions and actions need to take into consideration the legitimate interests of relevant stakeholders, may depend largely on the types of engagements the firm performs (e.g., audits of financial statements may have an increased stakeholder interest than agreed upon procedure engagements) and the nature of the entities for whom such engagements are performed (e.g., entities with a broader range of stakeholders).
 - (b) The communication of information in a firm with few personnel may involve less complex communication methods, such as informal staff meetings and day-to-day interactions. However, firms with many personnel, or personnel located in multiple geographical locations, may need multiple and more formal mechanisms for communication and such firms may also need to establish sophisticated information systems in order to obtain, generate and maintain relevant and quality information.
 - (c) The nature of the quality risks for a firm that has many staff performing engagements may differ from the nature of the quality risks for a firm that has few staff that provide multiple services to the firm's clients. For example, in relation to relevant ethical requirements, there may be an increased likelihood of a self-review threat in circumstances when a firm with few personnel performs both assurance and non-assurance services for a client (i.e., such personnel may be used for both engagements).

Authority of the ISQCs

9. ISQC 1 applies to all firms of professional accountants that perform audits or reviews of financial statements, or other assurance or related services engagements. [TO BE FURTHER CONSIDERED:

ISQC 2 applies to engagement quality control reviewers who perform an engagement quality control review of an audit or review of financial statements, or other assurance or related services engagements.]

10. The ISQCs contain the objective of the firm or the engagement quality control reviewer in following the ISQCs, and requirements designed to enable the firm or engagement quality control reviewer to meet that stated objective. In addition, they contain related guidance in the form of application and other explanatory material, as discussed further in paragraph 13, and introductory material that provides context relevant to a proper understanding of the ISQCs, and definitions.
11. The objective of the standard provides the context in which the requirements of the ISQC are set, and is intended to assist the firm or engagement quality control reviewer in:
 - Understanding what needs to be accomplished; and
 - Determining what needs to be done to achieve the objective.
12. The requirements of the ISQCs are expressed using “shall.”
13. Where necessary, the application and other explanatory material provides further explanation of the requirements and guidance for carrying them out. In particular, it may:
 - Explain more precisely what a requirement means or is intended to cover; and
 - Include examples that may be appropriate in the circumstances.

While such guidance does not in itself impose a requirement, it is relevant to the proper application of the requirements. The application and other explanatory material may also provide background information on matters addressed in the ISQCs. [*Where appropriate, additional considerations specific to public sector audit organizations, smaller firms or firms that operate as part of a network are included within the application and other explanatory material* (THIS IS TO BE FURTHER CONSIDERED)]. These additional considerations assist in the application of the requirements in the ISQCs. They do not, however, limit or reduce the responsibility of the firm or the engagement quality control reviewer to apply and comply with the requirements in the ISQCs.

14. The ISQCs include, under the heading “Definitions,” a description of the meanings attributed to certain terms for purposes of the ISQCs. These are provided to assist in the consistent application and interpretation of the ISQCs, and are not intended to override definitions that may be established for other purposes, whether in law, regulation or otherwise. The Glossary of Terms relating to International Standards issued by the IAASB in the *Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements* published by IFAC includes the terms defined in the ISQCs. It also includes descriptions of other terms found in the ISQCs to assist in common and consistent interpretation and translation.

Effective Date

15. Systems of quality management in compliance with this ISQC are required to be established by December 15, 20XX.

Objective

16. The objective of the firm is to establish and maintain a system of quality management to provide the firm with reasonable assurance that:

- (a) The firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements and conduct engagements in accordance with such standards and requirements; and
- (b) Reports issued in relation to engagements by the firm or engagement partners are appropriate in the circumstances.

Definitions

17. In this ISQC, the following terms have the meanings attributed below:

- (a) Date of report – The date selected by the practitioner to date the report.
- (b) Deficiency in the firm’s system of quality management – A shortcoming that reduces the likelihood that a quality objective(s) is achieved. (Ref: Para. A6–A7)
- (c) Engagement documentation – The record of work performed, results obtained, and conclusions the practitioner reached (terms such as “working papers” or “work papers” are sometimes used).
- (d) Engagement partner² – The partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.
- (e) Engagement quality control review – [TO BE CONSIDERED FURTHER IN CONJUNCTION WITH ISQC 2]
- (f) Engagement quality control reviewer – [TO BE CONSIDERED FURTHER IN CONJUNCTION WITH ISQC 2]
- (g) Engagement team – All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform procedures on the engagement. This excludes an auditor’s external expert engaged by the firm or by a network firm. The term “engagement team” also excludes individuals within the client’s internal audit function who provide direct assistance on an audit engagement when the external auditor complies with the requirements of ISA 610 (Revised 2013).³
- (h) External inspections – Inspections or investigations, undertaken by an external oversight authority, of the firm’s system of quality management or engagements performed by the firm.
- (i) Firm – A sole practitioner, partnership or corporation or other entity of professional accountants;⁴ (Ref. Para. A8)
- (j) Listed entity – An entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body.

² “Engagement partner,” “partner,” and “firm” should be read as referring to their public sector equivalents where relevant.

³ ISA 610 (Revised 2013), *Using the Work of Internal Auditors*, establishes limits on the use of direct assistance. It also acknowledges that the external auditor may be prohibited by law or regulation from obtaining direct assistance from internal auditors. Therefore, the use of direct assistances is restricted to situations where it is permitted.

⁴ “Firm” should be read as referring to its public sector equivalents where relevant.

- (k) Major deficiency – A deficiency that, individually or in combination with other deficiencies, severely reduces the likelihood of the firm achieving the component objective, or that results in the components not operating together.
- (l) Monitoring – A process comprising ongoing and periodic evaluations of whether the design and operation of the components of the firm’s system of quality management results in the achievement of the objective of this ISQC.
- (m) Network firm – A firm or entity that belongs to a network.
- (n) Network⁵ – A larger structure: (Ref. Para. A9–A10)
 - (i) That is aimed at cooperation, and
 - (ii) That is clearly aimed at profit or cost-sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand name, or a significant part of professional resources.
- (o) Partner – Any individual with authority to bind the firm with respect to the performance of a professional services engagement.
- (p) Personnel – Partners and staff.
- (q) Professional standards – IAASB Engagement Standards, as defined in the IAASB’s *Preface to the International Quality Control, Auditing, Review, Other Assurance and Related Services Pronouncements*, and relevant ethical requirements.
- (r) Root cause analysis – A process for investigating the underlying cause(s) of an identified deficiency, so that the underlying cause(s) can be appropriately addressed by the firm.
- (s) Quality objectives – The objectives established by the firm within a component that represent what is required to be achieved in order that the component objective is met.
- (t) Quality risk – A risk that could adversely affect the achievement of a quality objective(s).
- (u) Reasonable assurance – In the context of this ISQC, a high, but not absolute, level of assurance.
- (v) Relevant ethical requirements – [TO BE CONSIDERED IN THE CONTEXT OF THE IESBA’S RESTRUCTURE PROJECT AND WHETHER FOR PURPOSES OF ISQC 1 THIS SHOULD RELATE TO ALL STAFF] Ethical requirements to which the firm, engagement team and engagement quality control reviewer are subject, which ordinarily comprise Parts A and B of the IESBA Code together with national requirements that are more restrictive.
- (w) Remediation – A process to identify and implement corrective actions to address deficiencies identified in the firm’s system of quality management.

⁵ As defined in the Independent Ethics Standards Board for Accountants (IESBA) *International Code of Ethics for Professional Accountants* (Code)

- (x) Response (in relation to a quality risk) – [TO BE FURTHER CONSIDERED IN THE CONTEXT OF THE ISA 315 (REVISED)⁶ DISCUSSIONS] The firm’s actions, including policies or procedures, to address a quality risk.
- (y) Staff – Professionals, other than partners, including any experts the firm employs.
- (z) Suitably qualified external person – [TO BE CONSIDERED FURTHER IN CONJUNCTION WITH ISQC 2] An individual outside the firm with the competence and capabilities to act as an engagement partner, for example, a partner of another firm, or an employee (with appropriate experience) of either a professional accountancy body whose members may perform audits and reviews of historical financial information, or other assurance or related services engagements, or of an organization that provides relevant quality control services.

Requirements

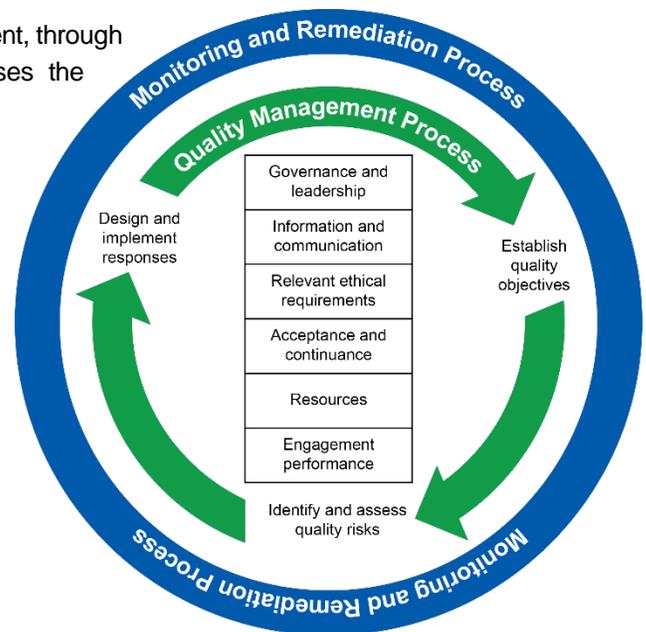
Applying, and Complying with, Relevant Requirements

- 18. The person(s) assigned ultimate responsibility and accountability and the person(s) assigned operational responsibility for the system of quality management shall have an understanding of this ISQC relevant to their responsibilities, including application and other explanatory material, to properly understand the objective of this ISQC and to apply its requirements properly.
- 19. The firm shall comply with each requirement of this ISQC unless, in the circumstances of the firm, the requirement is not relevant to the firm. (Ref: Para. A11)

System of Quality Management

- 20. The firm shall establish a system of quality management, through complying with paragraphs 22 to 69, that comprises the following eight components: (Ref: Para. A12)

- (a) A quality management process;
- (b) Governance and leadership;
- (c) Information and communication;
- (d) Relevant ethical requirements;
- (e) Acceptance and continuance of client relationships and specific engagements;
- (f) Resources; and
- (g) Engagement performance; and
- (h) A monitoring and remediation process.



⁶ ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

Quality Management Process

Objective of the Quality Management Process

22. The firm shall establish a quality management process that results in the design and implementation of responses that appropriately address the risks to the achievement of the quality objectives in the circumstances of the firm.

Requirements in Relation to the Quality Management Process

23. In meeting the component objective in paragraph 22, the firm shall:
- (a) Establish quality objectives relevant to the circumstances of the firm, including the nature of engagements performed by the firm, that are set at an appropriate level of granularity to enable the firm to identify and assess the quality risks. (Ref: Para. A13–A14)
 - (b) Identify and assess quality risks to the achievement of the quality objectives through: (Ref: Para. A15–A17)
 - (i) Understanding the conditions, events, circumstances, actions or inactions that could have an adverse impact on the firm's ability to achieve its quality objectives; and
 - (ii) Identifying and assessing the quality risks that, based on this understanding, individually or in combination could have an adverse impact on the firm's ability to achieve its quality objectives, other than those quality risks that are clearly trivial.
 - (c) Design and implement responses to the assessed quality risks in order to reduce the quality risk to an acceptably low level. The nature, timing and extent of such responses shall be based on and responsive to the assessed quality risks and responsive to the conditions, events, circumstances, actions or inactions that gave rise to the quality risks. (Ref: Para. A18–A24)
24. When there are changes in the circumstances of the firm, the firm shall determine whether the quality objectives, quality risks and responses remain appropriate and if not, modify them as necessary. (Ref: Para. A25–A27)
25. In establishing the quality objectives, identifying and assessing quality risks and designing responses, the firm shall address the following components:
- (a) Governance and leadership;
 - (b) Information and communication;
 - (c) Relevant ethical requirements;
 - (d) Acceptance and continuance of client relationships and specific engagements;
 - (e) Resources; and
 - (g) Engagement performance.

Governance and Leadership

Objective of the Governance and Leadership Component

26. The firm shall establish an environment, through the firm's culture, decision-making, actions, organization and leadership, that supports the operation of the other components of the system of quality management in achieving the objective of this ISQC.

Quality Objectives

27. In meeting the component objective in paragraph 26, the firm shall establish quality objectives that achieve the following:
- (a) The firm's internal culture promotes a commitment to quality, including professional values, ethics and attitudes, throughout the firm and emphasizes the responsibility of all firm personnel for quality in conducting engagements and performing functions in relation to the system of quality management. (Ref. Para A29–A30, A49)
 - (b) The firm's strategic decisions and actions reflect the firm's commitment to quality and the legitimate interests of relevant stakeholders, including that commercial considerations do not override the firm's commitment to quality. (Ref. Para A31–A33)
 - (c) The firm is organized and resources obtained and allocated in a manner that supports the effective design, implementation and operation of the firm's system of quality management. (Ref. Para A34–A39)
 - (d) The firm has effective leadership with responsibility and accountability for quality. (Ref. Para A40–A45)
 - (e) The requirements of law, regulation, or other professional standards that relate to the governance and leadership of the firm, if applicable. (Ref. Para A28)

Quality Risks

28. The firm shall identify and assess the quality risks for the quality objectives established by the firm in accordance with paragraph 27.

Responses to the Quality Risks

29. The firm shall design and implement responses to address the assessed quality risks in relation to governance and leadership. In designing and implementing those responses, the firm shall:
- (a) Assign ultimate responsibility and accountability for the system of quality management to the firm's chief executive officer (or equivalent) or, if appropriate, the firm's managing board of partners (or equivalent). The person(s) assuming such responsibility and accountability shall have sufficient and appropriate experience, knowledge and capacity to assume that responsibility and shall: (Ref. Para. A40–A42)
 - (i) Demonstrate a commitment to quality, including professional and ethical values and establish the expected values and behavior of all firm personnel for quality in conducting engagements and performing functions in relation to the system of quality management. (Ref. Para A29–A30, A49)

- (ii) Promote the firm's commitment to quality and the consideration of the legitimate interests of relevant stakeholders in the firm's strategic decisions and actions, including decisions that involve commercial considerations. (Ref. Para A31–A33)
 - (iii) Establish an organizational structure and obtain and allocate resources in a manner that supports the effective design, implementation and operation of the firm's system of quality management. (Ref. Para A34–A39)
- (b) Assign operational responsibility for the firm's system of quality management to a person(s) that has: (Ref: Para. A43–A45)
- (i) Sufficient and appropriate experience, knowledge and capacity to assume that responsibility;
 - (ii) A reporting line of communication to the person(s) assigned ultimate responsibility and accountability for quality; and
 - (iii) An understanding of their operational responsibilities for the firm's system of quality management.
- (c) Establish policies or procedures for periodic performance evaluations that evaluate the effectiveness of the person(s) assigned ultimate responsibility and accountability and the person(s) assigned operational responsibility for the system of quality management, as it relates to the firm's achievement of its quality objectives. The firm shall respond to the results of such performance evaluations. (Ref: Para. A46–A48)

Information and Communication

Objective of the Information and Communication Component

30. The firm shall obtain or generate and communicate sufficient and appropriate information that enables and supports the proper functioning of the firm's system of quality management. (Ref: Para. A50)

Quality Objectives

31. In meeting the component objective in paragraph 30, the firm shall establish quality objectives that achieve the following:
- (a) The firm obtains or generates relevant and quality information from both internal and external sources to support the operation of the components of the system of quality management. (Ref: Para. A51)
 - (b) The firm communicates information that enables all firm personnel to understand and carry out their responsibilities in relation to the system of quality management. (Ref: Para. A52–A54)
 - (c) The firm communicates information as required by law, regulation or relevant ethical requirements and exchanges other information relevant to the system of quality management, as necessary, with parties that are external to the firm, unless prohibited by law or regulation. (Ref: Para. A55–A56)

Quality Risks

32. The firm shall identify and assess the quality risks for the quality objectives established by the firm in accordance with paragraph 31.

Responses to the Quality Risks

33. The firm shall design and implement responses to address the assessed quality risks in relation to information and communication. In designing and implementing those responses, the firm shall:
- (a) Establish information systems, as appropriate, to identify, capture, process, maintain and communicate data and information to support the operation of the components of the system of quality management. (Ref: Para. A57 and A63)
 - (b) Communicate information related to the engagement team's responsibilities with respect to the firm responses that are required to be implemented at the engagement level. (Ref: Para. A19 and A58)
 - (c) Include responses relating to complaints and allegations that: (Ref: Para. A59–A62, A64)
 - (i) Enable reporting by the firm, its personnel or external parties of concerns in relation to the commitment to quality of the firm or its personnel, without fear of reprisal; and
 - (ii) Enable the investigation of concerns raised by the firm, its personnel or external parties.

Relevant Ethical Requirements

Objective of the Relevant Ethical Requirements Component

34. The firm, its personnel and, when applicable, others subject to relevant ethical requirements (including network firm personnel, as applicable), shall fulfill their responsibilities in respect of relevant ethical requirements.

Quality Objectives

35. In meeting the component objective in paragraph 34, the firm shall establish quality objectives that achieve the following: (Ref: Para. A65–A73)
- (a) The firm, its personnel and, when applicable, others subject to relevant ethical requirements (including network firm personnel, as applicable) have an understanding of relevant ethical requirements, including in relation to:
 - (i) Circumstances that may cause a breach of independence;
 - (ii) Their responsibilities in relation to circumstances when there is non-compliance with laws and regulations.
 - (b) The firm, its personnel and, when applicable, others subject to relevant ethical requirements (including network firm personnel, as applicable) fulfill their responsibilities in terms of relevant ethical requirements, including those relating to independence.
 - (c) The firm, its personnel and, when applicable, others subject to relevant ethical requirements (including network firm personnel, as applicable):

- (i) Identify threats to compliance with the principles of the relevant ethical requirements, including the independence requirements;
- (ii) Evaluate the threats identified;
- (iii) Address the threats by eliminating or reducing them to an acceptable level, by applying safeguards, declining the engagement or, if considered appropriate, withdrawing from the engagement, when withdrawal is possible under applicable law or regulation; and
- (iv) Evaluate whether the actions taken to address the threats to compliance with the principles of the relevant ethical requirements have eliminated those threats or reduced them to an acceptable level.

Quality Risks

36. The firm shall identify and assess the quality risks for the quality objectives established by the firm in accordance with paragraph 35.

Responses to the Quality Risks

37. The firm shall design and implement responses to address the assessed quality risks in relation to relevant ethical requirements. In designing and implementing those responses, the firm shall:
- (a) Assign operational responsibility for compliance with the independence requirements to a partner or partners or other persons with experience and authority in the firm to assume that responsibility.
 - (b) Obtain, at least annually, a written confirmation of compliance with the independence requirements from all firm personnel required by relevant ethical requirements to be independent.

Acceptance and Continuance of Client Relationships and Specific Engagements

Objective of the Acceptance and Continuance of Client Relationships and Specific Engagements Component

38. The firm shall accept or continue client relationships and specific engagements for which the firm is:
- (a) Satisfied with the integrity and ethical values of the client, including management, and, when appropriate, those charged with governance; and
 - (b) Able to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements.

Quality Objectives

39. In meeting the component objective in paragraph 38, the firm shall establish quality objectives that achieve the following:
- (a) The firm appropriately evaluates the integrity and ethical values of the client, including management, and, when appropriate, those charged with governance, when accepting or continuing a client relationship or specific engagement. (Ref. Para. A74–A76)

- (b) The firm appropriately evaluates its ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements when accepting or continuing a client relationship or specific engagement, including that the firm has appropriate resources and access to information that is necessary to be able to perform the engagement. (Ref. Para. A77–A78)
- (c) Management, and, when appropriate, those charged with governance, acknowledge and understand their responsibilities in relation to the engagement.
- (d) The firm appropriately considers, or responds appropriately, in circumstances when the firm becomes aware of information that: (Ref. Para. A79)
 - (i) Would have caused it to decline an engagement had that information been available prior to accepting or continuing a client relationship or specific engagement; or
 - (ii) Affects the firm's decision to continue a client relationship or specific engagement.

Quality Risks

40. The firm shall identify and assess the quality risks for the quality objectives established by the firm in accordance with paragraph 39.

Responses to the Quality Risks

41. The firm shall design and implement responses to address the assessed quality risks in relation to acceptance and continuance of client relationships and specific engagements.

Resources

Objective of the Resources Component

42. The firm shall obtain, use and allocate financial resources, human resources, technological resources, and intellectual resources that are sufficient and appropriate to:
- (a) Support the functioning of the firm's system of quality management;
 - (b) Perform engagements in accordance with professional standards and applicable legal and regulatory requirements; and
 - (c) Promote consistency in the quality of engagement performance.

Quality Objectives

43. In meeting the component objective in paragraph 42, the firm shall establish quality objectives that achieve the following:
- (a) The firm obtains, uses and allocates resources to support the performance of engagements and the operation of the system of quality management. (Ref: Para. A80–A82)
 - (b) The firm attracts, develops or retains personnel, including engagement partners, who have: (Ref: Para. A83–A84)
 - (i) Appropriate technical competence, professional skills and professional values, ethics and attitudes to perform engagements, including knowledge or experience regarding:

- a. The professional standards, including relevant ethical requirements, and applicable law or regulation in relation to the engagement being performed;
 - b. The industry in which the entity operates;
 - c. The underlying subject matter or the criteria to be applied in the preparation of the subject matter information; and
- (ii) Competence and experience to perform functions in relation to the operation of the firm's system of quality management.
- (c) The firm assigns an engagement partner and personnel to each engagement that have sufficient time, technical competence, professional skills and professional values, ethics and attitudes to effectively perform quality engagements and their responsibilities are clearly defined, communicated, and understood. (Ref. Para. A85–A88)
- (d) The firm undertakes performance evaluations or establishes compensation and promotion mechanisms that incentivize a commitment to quality and the maintenance and development of the competence and experience of firm personnel, including those performing engagements. (Ref: Para. A89)
- (e) The firm obtains or maintains technological resources that are necessary to support the operation of the firm's system of quality management and the consistent performance of engagements and: (Ref: Para. A90–A96)
- (i) Establishes and maintains an infrastructure or other resources appropriate to the firm's circumstances to support technological resources;
 - (ii) Implements security that addresses inappropriate access to technology; or
 - (iii) Appropriately addresses how technology is obtained, maintained or implemented.
- (f) The firm obtains or maintains intellectual resources that are necessary in supporting the consistent performance of engagements, and such intellectual resources are based on professional standards and applicable legal and regulatory requirements. (Ref: Para. A97–A98)

Quality Risks

44. The firm shall identify and assess the quality risks for the quality objectives established by the firm in accordance with paragraph 43.

Responses to the Quality Risks

45. The firm shall design and implement responses to address the assessed quality risks in relation to resources.

Engagement Performance

Objective of the Engagement Performance Component

46. The firm shall establish the manner in which engagements are appropriately directed and supervised, and the work performed is appropriately reviewed and assembled, to support the consistent performance of engagements and the judgments made by engagement teams.

Quality Objectives

47. In meeting the component objective in paragraph 46, the firm shall establish quality objectives that achieve the following:
- (a) The responsibilities of firm personnel in relation to engagements are determined and communicated, including responsibilities in relation to: (Ref. Para. A99–A101)
 - (i) Appropriate direction and supervision of the engagement team and review of the work of the engagement team; and
 - (ii) The appropriate review by more experienced engagement team members of work performed by less experienced team members.
 - (b) Responsibilities in relation to consultations are determined and communicated, appropriate consultation on difficult or contentious matters occurs and the conclusions resulting from consultations are agreed and implemented. (Ref. Para. A102–A105)
 - (c) Differences of opinion that arise within the engagement team, with the engagement quality control reviewer or with personnel performing functions in relation to the operation of the firm's system of quality management, including those who provide consultation, are dealt with or resolved. (Ref. Para. A106)
 - (d) Engagement files are assembled within an appropriate period of time after the engagement reports have been finalized, and engagement documentation is 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. A107–A115)

Quality Risks

48. The firm shall identify and assess the quality risks for the quality objectives established by the firm in accordance with paragraph 47.

Responses to the Quality Risks

49. The firm shall design and implement responses to address the assessed quality risks in relation to engagement performance. In designing and implementing those responses, the firm shall establish policies or procedures addressing engagement quality control reviews that: (Ref. Para. A116–A119)

[PLACEHOLDER TO DEMONSTRATE HOW ENGAGEMENT QUALITY CONTROL REVIEWS MAY BE INCORPORATED IN THE STANDARD. THE PARAGRAPHS BELOW AND RELATED APPLICATION MATERIAL ARE NOT FOR DISCUSSION AT THE DECEMBER 2017 IAASB MEETING]

- (a) Require an engagement quality control review to be performed for:
 - (i) All audits of financial statements of listed entities;
 - (ii) Engagements for which an engagement quality control review is required by law or regulation; and
 - (iii) Other engagements for which the firm has determined through its quality management process that an engagement quality control review is an appropriate response based on the assessed likelihood and impact of the quality risks.

- (b) Address the selection of the engagement quality control reviewer, and the performance and documentation of the engagement quality control review in accordance with ISQC 2.⁷

Monitoring and Remediation Process

Objective of the Monitoring and Remediation Process

50. The firm shall establish a monitoring and remediation process that evaluates the design and operation of the components of the firm's system of quality management through appropriate activities to identify and remediate the deficiencies in the firm's system of quality management. (Ref: Para. A120–A121)

Monitoring the Firm's System of Quality Management

51. The firm shall design and perform monitoring activities to evaluate the design and operation of the components of the firm's system of quality management, including the monitoring and remediation process. (Ref: Para. A122)
52. The firm shall determine the nature, scope and frequency of monitoring activities, including the appropriate combination of ongoing and periodic monitoring activities. In doing so, the firm shall take into consideration: (Ref: Para. A123–A130)
- (a) The assessment of the quality risks and the design of the responses to the quality risks;
 - (b) Changes in factors that have affected the firm's system of quality management;
 - (c) The results of 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
 - (d) Other information that may suggest deficiencies exist in the firm's system of quality management, including information from external inspections.
53. As part of its monitoring activities, the firm shall establish policies or procedures requiring the inspection of completed engagements. Such policies or procedures shall set out criteria for the selection of completed engagements for inspection that sufficiently support the firm in its evaluation of the design and operation of the components of the system of quality management. Such criteria shall include the inspection of at least one completed engagement for each engagement partner on a cyclical basis determined by the firm. (Ref: Para. A131–A133)
54. The firm shall:
- (a) Assign operational responsibility for the monitoring process to a partner or partners or other persons with sufficient and appropriate experience and authority in the firm to assume that responsibility and who has a reporting line of communication to the person(s) assigned ultimate responsibility and accountability for quality; and
 - (b) Determine that those performing the monitoring activities have sufficient and appropriate experience, knowledge and capacity to perform the monitoring activity and are objective in relation to the activity subject to monitoring. (Ref: Para. A134)

⁷ ISQC 2, *Engagement Quality Control Reviews*

Identifying and Remediating Identified Deficiencies

55. The firm shall evaluate the results of the monitoring activities and external inspections, and consider any other relevant information, in order to: (Ref: Para. A135–A138)
- (a) Identify and understand deficiencies;
 - (b) Investigate the root cause(s) of deficiencies and evaluate their effect;
 - (c) Determine whether the deficiencies, individually or in combination with other deficiencies, constitute major deficiencies; and
 - (d) Implement appropriate remedial actions, through complying with paragraphs 57–59.
56. 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, the firm shall: (Ref: Para. A139)
- (a) Determine what further action is necessary to comply with relevant professional standards and applicable legal and regulatory requirements; and
 - (b) Consider whether to obtain legal advice.
57. The firm shall investigate the root cause(s) of deficiencies. The nature, timing and extent of the procedures undertaken by the firm to investigate the root cause(s) of deficiencies shall be determined by the firm based on the nature of the deficiencies, including their perceived severity. In doing so, the firm shall determine whether the root cause(s) indicates that there is a deficiency in the design or operation of the firm's quality management process. (Ref: Para. A140–A146)
58. The firm shall evaluate the effect(s) of deficiencies in light of their identified root cause(s), and shall:
- (a) Design and implement remedial actions that are responsive to the root cause(s) of deficiencies and their related effect(s); and (Ref: Para. A147)
 - (b) Determine whether the deficiencies, individually or in combination with other deficiencies, represent a major deficiency. (Ref: Para. A148)
59. The firm shall perform an evaluation of whether the remedial actions are effectively designed and implemented to address the deficiencies and their related root cause(s). (Ref: Para. A149)

Communicating Matters Related to Monitoring and Remediation

60. The firm shall communicate, on a timely basis, but at least annually, information about the results of the firm's monitoring and remediation process that is relevant to engagement teams, personnel performing functions in relation to the operation of the firm's system of quality management, including the person(s) assigned ultimate responsibility and accountability and the person(s) assigned operational responsibility for the system of quality management, and parties that are external to the firm, as appropriate, unless prohibited by law or regulation. Information communicated shall include an appropriate description of the following: (Ref: Para. A150–A152)
- (a) The monitoring activities performed.
 - (b) Information about deficiencies, the root cause(s) of such deficiencies and remedial actions.

- (c) The results of the monitoring and remediation process, including the firm's determination of whether a deficiency, individually or in combination with other deficiencies, represents a major deficiency.
61. In circumstances when the firm has identified a major deficiency, the firm shall promptly communicate such deficiency to the person(s) assigned ultimate responsibility and accountability and the person(s) assigned operational responsibility for the system of quality management, who shall monitor the effectiveness of remedial action(s) planned and implemented to address such deficiencies.

Considerations Relating to Networks

62. In circumstances when the firm operates as part of a network, the firm shall:
- (a) Understand the nature of the relationship between the firm and the network; (Ref. Para. A153)
 - (b) Identify the services provided by the network that the firm intends to use in its system of quality management, including the components to which they relate; and (Ref. Para. A154–A155)
 - (c) Understand the expected form, timing and content of communications between the firm and the network in relation to the services provided by the network. (Ref. Para. A156)
63. In relation to the services provided by the network that the firm intends to use in its system of quality management, the firm shall:
- (a) Obtain an understanding of the network's process(es) related to the design, implementation, operation, as applicable, of the service(s), in order to evaluate whether the service is appropriate to use in the firm's system of quality management; and (Ref. Para. A157–A158)
 - (b) Determine the firm's supplementary actions that need to be implemented by the firm in order to use those services. (Ref. Para. A159)

Monitoring and Remediation Process

64. When the firm uses services provided by the network in relation to the monitoring and remediation process, the firm shall obtain the results of the monitoring activities performed by the network. (Ref: Para. A160–A161)
65. If the firm's monitoring activities identify deficiencies in the network's services, the firm shall communicate to the network relevant information about the identified deficiencies. (Ref: Para. A162)
66. If deficiencies are identified in relation to the network services used by the firm, the firm shall: (Ref: Para. A163)
- (a) Understand the planned remedial actions by the network;
 - (b) Understand whether the network's remedial actions are effectively designed and implemented to address the deficiencies relevant to the firm and their related root cause(s); and
 - (c) Determine the supplementary remedial actions needed by the firm, if any.

Considerations Relating to Use of Service Providers

[PLACEHOLDER: THE QCTF IS CONSIDERING MORE SPECIFIC REQUIREMENTS FOR CIRCUMSTANCES WHEN THE FIRM USES SERVICES PROVIDED BY THIRD PARTY SERVICE PROVIDERS]

Documentation

67. The firm shall prepare documentation of its system of quality management that is sufficient to: (Ref: Para. A164–A167)
- (a) 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) Provide evidence of the operation of each component, such that the firm is able to evaluate the design, implementation and operation each component, individually and in an integrated manner.
68. The documentation shall include: (Ref: Para. A168, A170)
- (a) The firm’s quality objectives and quality risks;
 - (b) A description of the responses and how the firm’s responses address the firm’s quality risks;
 - (c) When relevant, the results of periodic performance evaluations, as contemplated by paragraph 29(c), including the firm’s corrective actions to address performance issues that are identified from such performance evaluations;
 - (d) In relation to the monitoring and remediation process:
 - (i) Evidence of monitoring activities performed;
 - (ii) The evaluation of the results of the monitoring activities, external inspections and other information;
 - (iii) Identified root cause(s) and remedial actions to address root cause(s);
 - (iv) The evaluation of the effect of identified deficiencies;
 - (v) Communications about deficiencies;
 - (e) In relation to the engagement quality control review:
 - (i) The policies or procedures in relation to engagements that require an engagement quality control review to be performed; and
 - (ii) The selection of individual engagements subject to engagement quality control review.
69. 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 permits those performing monitoring procedures to evaluate the firm’s system of quality management.

Application and Other Explanatory Material

Scope of this ISQC (Ref: Para. 2)

- A1. Other pronouncements of the IAASB, for example ISA 220, ISRE 2400 (Revised)⁸ and ISAE 3000 (Revised),⁹ establish requirements for the engagement partner in relation to the management of quality at the engagement level that include implementing the firm's responses to quality risks at an engagement level. Furthermore, ISA 220 establishes requirements for the engagement partner to consider whether additional responses to the firm-level responses are necessary in order to appropriately manage quality at the engagement level.

The Firm's System of Quality Management (Ref: Para. 3–8)

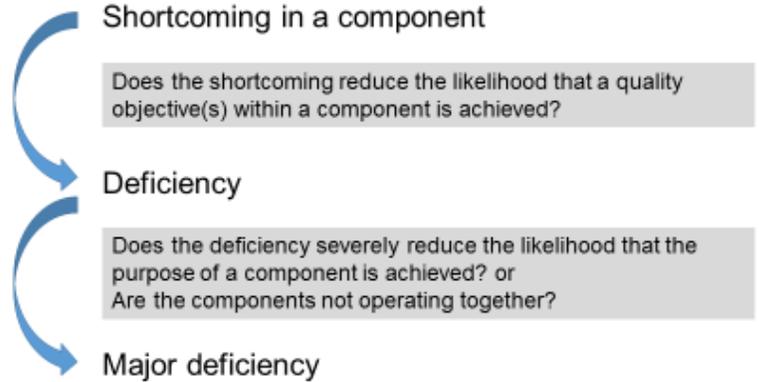
- A2. Reasonable assurance is a high level of assurance and is obtained when the firm's system of quality management reduces the risk that the firm does not achieve the overall objective of the system of quality management to an acceptably low level. However, reasonable assurance is not an absolute level of assurance, because there are inherent limitations of a firm's system of quality management. Such limitations include the reality that human judgment in decision-making can be faulty and that breakdowns in the firm's system of quality management may occur because of human error or behavior.
- A3. The firm's system of quality management is a dynamic, iterative and integrated process and the components are interconnected. For example, the firm's governance and leadership, including the actions and tone of firm leadership, establish the environment in which the system of quality management operates and may influence the nature and extent of the quality objectives, quality risks and responses in relation to other components. In order for the firm's system of quality management to achieve its objective, the firm designs and operates each component in accordance with this standard in an integrated manner. The firm's monitoring activities determine whether the objective of the firm has been met through evaluating:
- The design and operation of each component in accordance with this standard; and
 - Whether the components are operating an integrated manner.

Accordingly, the firm's evaluation of the system of quality management involves a determination of whether the components collectively prevent, detect and correct deficiencies in the system of quality management, such that the risk that the firm does not achieve the objective of the system of quality management is reduced to an acceptably low level.

⁸ International Standard on Review Engagements (ISRE) 2400 (Revised), *Engagements to Review Historical Financial Statements*

⁹ International Standard on Assurance Engagements (ISAE) 3000, *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*

A4. A deficiency in the system of quality management occurs when a shortcoming is identified by the firm through its monitoring activities or other information, and the firm determines that the shortcoming reduces the likelihood that a quality objective(s) is achieved. If the firm determines that a deficiency, individually or in combination with other deficiencies, severely reduces the likelihood of the firm achieving the component objective (e.g., the deficiency is severe or systemic in nature), or results in the components not operating together, the deficiency is considered to be a major deficiency. When a major deficiency exists, the firm may not have reasonable assurance that the overall objective has been met.



A5. Under this ISQC, the firm is required to implement remedial actions to address deficiencies. When the firm has determined that a major deficiency exists, until such time as the major deficiency has been remediated, the firm may not have reasonable assurance that the objective of the system of quality management has been met. Remedial actions implemented by the firm to address a major deficiency may include both short-term measures and more robust responses that take longer to develop.

Definitions

Deficiency in the Firm's System of Quality Management (Ref: Para. 17(b))

A6. Examples of a shortcoming include:

- A response designed and implemented by the firm is ineffective in addressing a quality risk.
- The firm fails to identify or implement a response, i.e., no response exists to address a quality risk.
- The firm fails to establish an appropriate quality objective, resulting in a quality risk not being identified (e.g., the quality objective is not set at an appropriate level of granularity to enable the identification and assessment of a quality risk).
- The firm fails to identify an appropriate quality risk(s) in relation to the quality objective(s), resulting in an inappropriate or ineffective response(s) being designed and implemented.

In addition to the shortcoming in the component to which the quality objective, quality risk or response relates, the above shortcomings may also be an indication of a shortcoming in the quality management process itself. Examples of a shortcoming in relation to monitoring and remediation include:

- The firm's monitoring activities are ineffective in supporting the firm's evaluation of the design and operation of the components of the firm's system of quality management.
- A remedial action is ineffectively designed or implemented to address a deficiency and its related root cause(s).

- A7. The quality objectives in relation to the quality management process and the monitoring and remediation process are embedded in the requirements set out in this ISQC.

Firm (Ref: Para. 17(i))

- A8. The definition of “firm” in relevant ethical requirements may differ from the definition set out in this ISQC. For example, the IESBA Code defines the “firm” as:
- (a) A sole practitioner, partnership or corporation of professional accountants;
 - (b) An entity that controls such parties through ownership, management or other means; and
 - (c) An entity controlled by such parties through ownership, management or other means.

In complying with the requirements in this ISQC, the definitions used in the relevant ethical requirements apply in so far as is necessary to interpret those ethical requirements.

Network (Ref: Para. 17(n))

- A9. The definitions of “network” or “network firm” in relevant ethical requirements may differ from those set out in this ISQC. The IESBA Code also provides guidance in relation to the terms “network” and “network firm.” Networks and the firms within the network may be structured in a variety of ways, and are in all cases external to the firm. The provisions in this ISQC in relation to networks apply to any structures that do not form part of the firm, but that exist within the network.
- A10. In some instances, there may be service delivery models established within the network, for example, a shared service center, center of excellence, on-shoring, offshoring or outsourcing. Such service delivery models may be established by the network, the firm, or other firms within the network. Throughout this ISQC, in circumstances when reference is made to a network, it includes a service delivery model established by the network or another firm within the network.

Applying, and Complying with, Relevant Requirements (Ref: Para. 19)

- A11. The requirements are designed to enable the firm to achieve the objective of this ISQC stated in paragraph 16. The proper application of the requirements is therefore expected to provide a sufficient basis for the achievement of the objective of this ISQC. This ISQC does not call for compliance with requirements that are not relevant. For example, in the circumstances of a sole practitioner with no staff, the requirements in this ISQC in relation to the following may not be relevant due to the absence of staff:

- Communicating appropriate information necessary to enable and support the proper functioning of the firm’s system of quality management.
- Establishing a complaints and allegations process that enables reporting, without fear of reprisal, of concerns in relation to the commitment to quality of the firm or its personnel.
- Establishing an organizational structure and assigning responsibility, for example, operational responsibility for the system of quality management or operational responsibility for the monitoring and remediation process.
- Undertaking periodic performance evaluations that assess the effectiveness of firm leadership.

System of Quality Management (Ref: Para. 20)

A12. Both internal and external factors, such as the following, may be relevant considerations in establishing the firm's system of quality management:

- Economic, regulatory, jurisdictional, technological and social factors.
- The organization of the firm, including the geographic dispersion or use of service delivery models, for example, shared service centers or outsourced service providers.
- In circumstances when the firm is within a network, how the network is organized and the extent to which the firm uses the services of the network.
- The firm's resources, including financial, technological, intellectual and human resources.
- The types of services the firm provides, the industries it serves and the nature of the entities to whom the services are provided.
- The firm's stakeholders, for example, users of the firm's reports, regulatory authorities, preparers and those charged with governance.

Quality Management Process (Ref: Para. 22–25)

Establish Quality Objectives (Ref: Para. 23(a))

A13. The quality objectives established by the firm in relation to each component may include quality objectives that are more granular than the quality objectives required by this ISQC in relation to the various components, in order to reflect the circumstances of the firm and the nature of engagements performed by the firm. The firm applies professional judgment in determining whether additional or more granular quality objectives are necessary in the circumstances of the firm. For example, more granular quality objectives may be appropriate in circumstances when the firm's quality objectives need to be broken-down into related sub-objectives because the operations within the firm are structured across divisions, operating units, or other such functions (e.g., quality objectives specific to a particular division of the firm, including the firm's service delivery model).

A14. The quality objectives across the various components are interrelated. For example, relevant ethical requirements include objectives in respect of the firm's independence requirements, which are also related to the quality objectives addressing the acceptance and continuance of client relationships and specific engagements.

Identify and Assess Quality Risks (Ref: Para. 23(b))

A15. The identification and assessment of the quality risks forms the basis for the firm's determination of the nature, timing and extent of the firm's response to such quality risks. Quality risks are those risks relevant to the circumstances of the firm, that arise from conditions, events, circumstances, actions or inactions that could have an adverse impact on the firm's ability to achieve its quality objectives, which may include the factors set out in paragraph A12. For example, firms that perform a variety of complex engagements may have a heightened need for technical resources to support consultation and accordingly the risk that such technical resources are not available may be more significant for such firms.

A16. The firm applies professional judgment in identifying and assessing the quality risks and the process may involve a combination of ongoing and periodic risk identification and assessment procedures. In

some circumstances, it may be appropriate to identify the quality risks as the inverse of the quality objectives; however in other circumstances the firm may identify quality risks that are more granular than the quality objectives, in order to facilitate the design of appropriate responses. The assessment of the quality risks ordinarily focuses on how the conditions, events, circumstances, actions or inactions could impact the firm, and need not comprise formal ratings or scores. In assessing the quality risks, the firm may consider:

- The likelihood of whether or not the quality risk could occur and the expected frequency of its occurrence.
- The impact of the quality risk on the firm, including:
 - The rate at which the impact would take place, or the amount of time that the firm has to respond to the quality risk. For example, when changes in professional standards are effected, there is typically a period of time allowed for implementation. On the other hand, the effect of high turnover of firm personnel may be more immediate and the firm may not have been able to prepare for such an event.
 - The duration of time of the impact after the quality risk has occurred. For example, a change in a professional standard may have a more long-term impact when it becomes effective, since the firm may need to train its personnel on the changes or update methodology, although the effect of such change may lessen over time. Conversely, a breach of the firm's independence policies or procedures may have a more short-term or immediate effect.

A17. Paragraph 23(b) indicates that the firm is not required to identify those quality risks that are clearly trivial. Clearly trivial quality risks are those that would not affect the firm's ability to achieve its quality objective(s), either individually or in combination with other quality risks, because the likelihood that the quality risk will occur or the impact of the quality risk if it did occur is at an acceptably low level. In general, the firm does not consider a quality risk to be clearly trivial in circumstances when the firm is uncertain about whether a quality risk, individually or in combination with other quality risks, is clearly trivial.

Design and Implement Responses to Quality Risks (Ref: Para. 23(c))

A18. The nature of the response to a quality risk may include, among others, establishing policies or procedures, assigning responsibility, communicating, providing training, performing reviews or assigning resources. This ISQC prescribes certain responses that are required to be implemented by the firm, for example, paragraph 49 requires the firm to establish policies or procedures regarding the scope of engagements for which an engagement quality control review is required to be performed. The firm designs and implements responses in conjunction with the required responses in order to effectively address the quality risks. For example, in relation to engagement performance, in addition to establishing policies or procedures for engagement quality control reviews for audits of financial statements of listed entities, the firm may identify other responses to address quality risks associated with other engagements that are not required to be subject to an engagement quality control review (e.g., specified reviews of engagement team work on significant risks or reviews by individuals within the firm who have specialized technical expertise).

A19. The level at which the responses are implemented may vary, for example:

- The firm may implement the response at the firm level (e.g., the firm develops an audit software tool for use by engagement teams performing audits of financial statements).

- The engagement partner or engagement team may implement the response at the engagement level (e.g., the engagement partner forms a conclusion on compliance with independence requirements, established by the firm that apply to the engagement).

In many cases, although a response may be implemented at the firm level, there may be supplementary actions at the engagement level in order that the response operates as designed. For example, the firm may establish human resources to support technical consultations, however the engagement team has a responsibility to identify circumstances when consultation is needed and follow the firm's processes in consulting with the technical resources. Communicating the responsibilities of engagement teams for the implementation and operation of responses is therefore important for the functioning of the system of quality management. ISA 220, ISRE 2400 (Revised) and ISAE 3000 (Revised) establish requirements for the engagement partner in relation to the management of quality at the engagement level and further require that the engagement partner implement firm level requirements at the engagement level.

Policies or Procedures

- A20. Policies established by the firm ordinarily include guiding principles in relation to a matter, while procedures ordinarily facilitate a consistent process that should be followed in relation to a matter. Depending on the nature of the matter, the firm may determine it appropriate to establish a policy, procedure, or combination of both. Certain requirements of this ISQC require the firm to establish policies or procedures.
- A21. Structured documentation of the firm's policies or procedures may not be necessary in all circumstances, for example, the policies or procedures could be stated in communications or implied through the actions and decisions of firm leadership. Nevertheless, a lack of awareness of the firm's policies or procedures and the circumvention of policies or procedures is more possible when they are not documented. The need for formal policies or procedures may be greater for firms that have many personnel or that have geographical dispersion, in order to achieve consistency across the firm.

Nature, Timing and Extent of the Firm's Response

- A22. The nature, timing and extent of the firm's responses to the identified quality risk depends on the conditions, events, circumstances, actions or inactions that give rise to the quality risk and the assessment of the quality risk. For example, if the firm's quality risk relates specifically to a particular industry or category of clients (e.g., audits of financial statements of listed entities), the firm's responses may require specific actions in relation only to clients in the industry or that are within the category, rather than all engagements performed by the firm. In some circumstances, a quality risk may not require any action, or the firm may choose to avoid the risk, for example, by not providing a particular service to which the quality risks relates.
- A23. The nature, timing and extent of the firm's responses may also vary based on factors such as the size and complexity of the firm. For example, in a smaller firm, due the concentration of the firm's operations, the closer oversight by the firm's leadership may be an effective and appropriate response to certain risks. In addition, in some circumstances, the response may be more effectively established at an engagement level, for example, a smaller firm may perform only a few engagements of a specific type and it may be more effective for the quality risk to be addressed directly at the

engagement level rather than establishing formal policies or procedures at the firm level that are applied at the engagement level.

A24. In designing a response to a quality risk, the firm may consider many factors, including:

- Whether the response should involve a preventative activity, a detective activity or a combination of both. For example, a preventative activity would include developing the knowledge of firm personnel regarding independence requirements in order to prevent breaches of independence, and a detective activity would include systems that check compliance with independence requirements by firm personnel.
- Whether the response should be a manual process or whether the quality risk would be more appropriately addressed through automated means, for example, the firm may be able to use data analytic techniques or other technologies.
- The appropriate timing of the response activities, for example, certain activities may need to operate on a continual basis in order to be effective (e.g., monitoring and reporting breaches of the firm's independence policies or procedures).
- Whether the response alone is sufficient to address the quality risk, i.e., a combination of responses may be necessary to appropriately address the quality risk.
- Whether there are responses that address multiple quality risks and therefore may be more effective to design and implement.
- The appropriate resources to support the response. For example, certain responses may need to be performed by competent personnel with the appropriate knowledge, time and experience, or the firm may need to source technological or intellectual resources to support the functioning of the response (e.g., application systems and hardware or a firm methodology for the performance of engagements).
- The information to be obtained, generated and communicated in relation to the response.
- When the response is designed to identify deviations, clarifying how they will be addressed. For example, in the case of a preissuance review, the firm may factor the results of the preissuance review into performance evaluations.

Determining Whether the Quality Objectives, Quality Risks and Responses Remain Appropriate (Ref: Para. 24)

A25. In establishing the firm's system of quality management, the firm considers both internal and external factors, for example, those described in paragraph A12. These factors may change over time, the frequency of which depends on the rate of change in the factors and circumstances and how often information becomes available to the firm. Such changes may result in the need for the firm to revise its quality objectives, quality risks and responses. For example, a new service offering by the firm may cause the firm to consider whether its quality objectives, quality risks and responses are appropriate for the new service offering, or new software may become available that allows the firm to more effectively address a particular quality risk.

A26. Quality objectives, quality risks and responses in relation to a component may also need to be revised as a result of changes in another component.

A27. The appropriateness of the quality objectives, quality risks and responses may need to be considered in circumstances when deficiencies in the system of quality management are identified. For example, in understanding the root cause of a deficiency, the firm may identify that the deficiency arose as a result of an inappropriate quality objective, quality risk or response. Furthermore, the firm's monitoring activities may identify deficiencies in the firm's process to establish objectives, identify and assess quality risks and design and implement responses.

Governance and Leadership (Ref: Para. 26–29)

A28. Law, regulation or other professional standards may prescribe additional matters related to the governance of the firm, for example, the firm may be required to follow an audit firm governance code that may incorporate specific governance principles and require adherence to specific provisions.

Internal Culture (Ref: Para. 27(a) and 29(a)(i))

A29. The firm's internal culture is an important factor in influencing how its personnel function in performing engagements, while at the same time accomplishing the firm's commercial goals. A firm with a quality-focused culture recognizes and reinforces the importance of professional values, ethics and attitudes through, for example, a commitment to:

- Technical competence and professional skills;
- Ethical behavior;
- Professional manner, for example, due care, timeliness, courteousness, respect, responsibility, and reliability;
- Pursuit of excellence, for example, a commitment to continual improvement; and
- Social responsibility.

A30. An internal culture that promotes the conduct of quality engagements is likely to involve clear, consistent, frequent and effective actions, including communication, at all levels within the firm that emphasize the firm's commitment to quality. The tone at the top and the attitude to quality, including professional values, ethics and attitudes, is set by the person(s) assigned ultimate responsibility and accountability for the system of quality management through their operating style and personal conduct. This is further shaped and reinforced by the firm's personnel who are expected to embed or demonstrate the behaviors that confirm the firm's commitment to quality. The actions undertaken to foster a culture of quality throughout the firm by those assigned ultimate responsibility and accountability for the system of quality management may include:

- Defining the purpose and values of the firm, as well as the expected behaviors of the firm's personnel.
- Establishing trust through consistent, regular and open communication within the firm and through establishing policies or procedures to deal with complaints and allegations.
- Establishing responsibility and accountability for quality, for example, through clearly defining and communicating roles and responsibilities throughout the firm and defining how internal quality will be measured.
- Providing transparency within the firm about the firm's actions to address quality, and the effectiveness of those actions.

- Establishing policies or procedures to address recruitment, development, compensation, and promotion with regard to its personnel that support and encourage behaviors that are consistent with the firm's purpose, values and strategy.
- Establishing appraisal and reward systems that promote personal characteristics that support and reinforce the firm's view on the importance of quality, and providing personnel with continuing professional development opportunities.
- Promoting a culture of consultation on difficult issues and providing access to high-quality technical support.
- Implementing robust systems for supporting decisions about the acceptance and continuance of client relationships and specific engagements.
- Monitoring the effectiveness of actions implemented to embed the culture and evaluating whether the outcome of monitoring activities are reflective of an internal culture that focuses on professional values, ethics and attitudes and the performance of quality engagements.

The extent of such actions may depend on a variety of factors, including the size, structure, geographical dispersion and complexity of the firm. For example, a smaller firm may be able to influence the desired culture through less extensive actions due to the close interaction of firm leadership with the firm's personnel.

Strategic Decisions and Actions and Relevant Stakeholders (Ref: Para. 27(b) and 29(a)(ii))

- A31. The firm may have a variety of relevant stakeholders, including the network or other network firms, audit oversight bodies and other external bodies, those charged with governance of the firm's clients or users of the firm's reports. In the case of a smaller firm, the extent of stakeholders may be more limited depending on the nature of engagements undertaken by the firm and the entities for which such engagements are performed.
- A32. The firm's strategic decision-making process, which may include establishing a business strategy, takes into consideration, in addition to the firm's commercial interests, how its decisions affect the quality of engagements performed, as well as the legitimate interests of its relevant stakeholders. This supports the firm's recognition of its professional values and ethics in the conduct of engagements. Commercial considerations that may impair quality may include excessive cost-cutting at times of economic downturn that damage the provision of quality in the medium term or internal training that is disproportionately focused on improving client service at the expense of necessary training to develop technical competence.
- A33. Stakeholders' perception of the quality of engagements performed by the firm may be improved when they consider that the firm supports and embeds a quality-focused culture that emphasizes professional values, ethics and attitudes in the conduct of engagements. Confidence may be increased if stakeholders are made aware of the firm's activities that it has undertaken to address quality, and the effectiveness of those actions. As a result, the firm's ability to maintain stakeholder confidence in the quality of its engagements may be enhanced through effective two-way communication between the firm and its stakeholders. How the firm effects such communication may vary, for example, the firm may assign responsibility for stakeholder communication to a governing body who is able to independently initiate dialogue with the firm's stakeholders and prompt feedback in a manner that facilitates candid discussion. In some circumstances, the firm may communicate with stakeholders through a transparency report. Paragraph XX addresses circumstances when the

firm is required to prepare a transparency report. [PLACEHOLDER FOR WHEN TRANSPARENCY REPORTING IS FURTHER DEVELOPED]. In the case of a smaller firm, there may not be a need to communicate with stakeholders in this manner.

Organization of the Firm and Resources (Ref: Para. 27(c) and 29(a)(iii))

A34. Organizing the firm in a manner that supports the effective design, implementation and operation of the firm's system of quality management may include:

- Establishing an internal firm structure that is commensurate with the size and operating characteristics of the firm and the services the firm provides; and
- Designating authority and responsibility within the firm.

A35. The internal firm structure includes the leadership and management structure of the firm as well as how the firm is organized into divisions or geographical locations. Smaller firms may have simple structures comprising a single partner with responsibility for the oversight of the firm. The leadership of a larger firm may comprise a chief executive officer (or equivalent), managing board of partners (or equivalent) or other person(s). In some circumstances, the firm may also have an independent governing body or board of partners that has executive oversight of the firm, or committees may be established to fulfill specific leadership functions. At a jurisdictional level, law or regulation may prescribe the leadership and management structure of the firm, for example, certain jurisdictions mandate the appointment of a governing body comprising a minimum number of independent non-executive members and prescribe the function or responsibilities of those appointed within these roles.

A36. In establishing the firm's leadership and management structure, the firm may consider:

- The required knowledge, experience and capacity necessary to fulfill the identified roles; and
- The need for other attributes that contribute to the firm's commitment to quality, for example, appointing individual(s) who are independent to the board of partners or who are not involved in the operational aspects of the firm and are therefore able to provide impartial judgment in the firm's decision-making, that takes into consideration the legitimate interests of relevant stakeholders.

A37. Depending on the geographical dispersion, size, structure and complexity of the firm, the firm may determine it more effective to centralize responsibility for certain functions to achieve a desired level of consistency. However, in other cases the firm may determine that decentralizing responsibilities is more effective. Clearly communicating reporting lines, roles, authority and responsibilities to the firm's personnel supports those assigned responsibility in performing their functions and establishes their accountability.

A38. The organization of the firm may include structures that provide the necessary resources to support the firm's system of quality management and engagement teams in the performance of engagements. For example, the firm may organize its structure to include service delivery models, such as a shared service center, center of excellence, on-shoring, offshoring or outsourcing.

Resources

A39. Obtaining resources and allocating them appropriately is essential for the proper functioning of the firm's system of quality management and supporting the performance of the firm's engagements.

Those assigned ultimate responsibility and accountability for the system of quality management are in a unique position to influence the extent of resources that the firm obtains and maintains, and how the firm's resources are allocated. Resources include those set out in paragraph A80.

Firm Leadership Responsibility and Accountability (Ref: Para. 27(d) and 29(a))

- A40. Identifying those who are ultimately responsible and accountable for the system of quality management depends on the circumstances of the firm and may also be influenced by jurisdictional requirements in relation to how the firm is structured. In some circumstances, the managing board of partners (or equivalent) may have responsibility for overseeing the firm's operations and allocating resources, and therefore it may be appropriate for such managing board of partners (or equivalent) to have shared responsibility and accountability for the system of quality management. In the case of a smaller firm, there may be an individual partner who has ultimate responsibility and accountability for the system of quality management.
- A41. Accountability for the system of quality management may be established through various actions, including evaluating the achievement of the objective of the system of quality management. Communication of relevant information about the results of the firm's monitoring and remediation process to those assigned ultimate responsibility and accountability for the system of quality management, including when major deficiencies are identified, supports the accountability of firm leadership, since firm leadership has the responsibility to take prompt and appropriate action, when necessary, in response to such information.
- A42. Sufficient and appropriate experience, knowledge and capacity to assume ultimate responsibility for the system of quality management enhances the authority of the individual(s) assigned such responsibility and supports their understanding of how to fulfill the responsibilities set out in this standard. In some circumstances, such individual(s) may need to have experience and knowledge in relation to the engagements performed by the firm, in order to understand the importance of engagement quality and demonstrate behaviors that embed the firm's culture. However, in other circumstances, the firm's internal structure may enable the individual(s) with ultimate responsibility for the system of quality management to be supported by other person(s) within the firm with sufficient and appropriate experience in relation to the engagements performed by the firm. For example, such support may be enabled when such person(s) has a direct reporting line of communication to the individual(s) with ultimate responsibility for the system of quality management.

Operational Responsibility for the Firm's System of Quality Management (Ref: Para. 29(b))

- A43. Those assigned ultimate responsibility for the system of quality management are responsible and accountable for the system achieving its objective. Person(s) with operational responsibility for the system of quality management are responsible and accountable for the design and implementation of the firm's system of quality management. In some circumstances, the person(s) assigned operational responsibility for the system of quality management are the same as the person(s) who are assigned ultimate responsibility and accountability for the system of quality management. Paragraphs 37(a) and 54(a) require the firm to assign operational responsibility for independence and the monitoring and remediation process. In some instances, the person(s) with operational responsibility for the system of quality management may also be assigned these responsibilities.
- A44. Sufficient and appropriate experience and knowledge enables the person(s) assigned operational responsibility for the firm's system of quality management to identify and understand quality

management issues. Furthermore, it is necessary that the person(s) have adequate time to discharge their responsibilities.

- A45. The accountability of those assigned operational responsibility for the firm's system of quality management is established through periodic performance evaluations that assess their effectiveness, as required by paragraph 29(c), and may be further established by:
- Monitoring the firm's system of quality management and providing incentives for actions to be implemented, for example, by pre-defining internal quality measures, and evaluating such measures against targets.
 - Establishing appraisal and reward systems that address the responsibilities and promote personal characteristics that support and reinforce the firm's view on the importance of quality.

Performance Evaluations (Ref: Para. 29(c))

- A46. The performance evaluations contemplated by paragraph 29(c) apply to the person(s) assigned ultimate responsibility for the system of quality management and the person(s) assigned operational responsibility for the system of quality management, including those assigned operational responsibility for independence and the monitoring and remediation process. Given the unique position of the person(s) assigned ultimate responsibility for the system of quality management, the performance evaluations may be undertaken by an independent non-executive member of the firm's governing body, a special committee, or an external service provider. In the case of smaller firms, it may not be practicable to perform performance evaluations, however in such cases, the results of the firm's monitoring activities are often indicative of the performance of the person(s) with ultimate or the person(s) with operational responsibility for the system of quality management.
- A47. Periodic performance evaluations of individual(s) within the firm may form part of the firm's monitoring activities, and may also establish accountability for the responsibilities assigned in relation to the system of quality management. In considering the performance of individuals, the firm may take into consideration:
- The results of the firm's monitoring activities;
 - The actions taken by the individuals in response to deficiencies identified and their related root causes, as appropriate in relation to their responsibilities; or
 - The effectiveness of remedial actions implemented to address deficiencies.
- A48. The results of the performance evaluations may be positive, i.e., they may indicate that firm leadership has fulfilled their responsibilities in terms of this ISQC. A positive outcome may be rewarded through remuneration or other rewards. On the other hand, when the results of the performance evaluations are negative, corrective actions may be taken by the firm to address performance issues that are identified and which may affect the firm's achievement of its quality objectives.

Considerations in Relation to Networks

- A49. The internal culture of the firm may be influenced and supported by the network, for example, through the tone of leadership at the network level regarding the importance of quality in conducting engagements and how the network manages and responds to matters in relation to quality.

Information and Communication (Ref: Para. 30–33)

A50. Obtaining or generating and communicating information is generally an ongoing process that involves all firm personnel and encompasses the dissemination of information within the firm and externally. Sufficient and appropriate information includes information that is relevant, accurate, complete, timely and valid to support the proper functioning of the firm's system of quality management.

A51. Examples of the information that is needed in relation to the components include:

- Quality management process:
 - Information in order to be able to establish objectives, identify and assess quality risks and design and implement responses.
 - Information that is necessary for the operation of the responses to quality risks.
- Governance and leadership:
 - Information necessary to support decision-making and an assessment of the firm's activities and performance.
 - Information needed to support an evaluation of the firm's resource needs.
 - Information necessary to meet external regulatory requirements.
 - Information to support an understanding of the responsibilities in relation to the firm's system of quality management and to support individuals in fulfilling their responsibilities.
- The monitoring and remediation process:
 - Information in order to design and perform monitoring activities, including information necessary to establish policies or procedures in relation to engagement inspections.
 - Information in order to evaluate whether those performing monitoring activities have sufficient and appropriate experience, knowledge and capacity to perform the monitoring activity and are sufficiently objective from the activity subject to monitoring.
 - Information from other sources in order to identify deficiencies in the firm's system of quality management.
 - Information in order to understand the root causes and effects of deficiencies identified.
 - Information to evaluate the effectiveness of the remedial actions.

A52. Communication is the means through which the firm and its personnel share relevant information to support the proper functioning of the firm's system of quality management and the management of quality at the engagement level. Parties with whom two-way communication is undertaken may include:

- Engagement teams;
- Personnel performing functions in relation to the operation of the firm's system of quality management, including those assigned ultimate or operational responsibility for the firm's system of quality management; or
- Parties that are external to the firm.

Firm personnel's responsibilities for communication may include, for example, communicating information about identified threats to, or breaches of, the firm's independence policies or procedures to the firm.

A53. Paragraphs 33(b) and 60 require information in relation to responses and the monitoring and remediation process to be communicated to engagement teams. Examples of other information relating to the firm's system of quality management that the firm may communicate to engagement teams include:

- Information related to the firm's culture, for example, the message that each individual has a personal responsibility for quality and is expected to comply with the firm's policies or procedures.
- Information that describes the authority, roles and responsibilities of personnel performing functions in relation to the engagement.
- Information obtained from the network about the system of quality management of another network firm that is relevant to engagement teams who use the network firm in the performance of a group audit.

A54. Paragraph 60 requires information in relation to the monitoring and remediation process to be communicated to personnel performing functions in relation to the operation of the firm's system of quality management, including those who have ultimate or operational responsibility for the system of quality management. Examples of other information relating to the firm's system of quality management that may be communicated to such personnel include:

- Information that describes the authority, roles and responsibilities of personnel performing functions in relation to the operation of the firm's system of quality management.
- Information that supports the oversight of the firm's system of quality management by those who are ultimately responsible and accountable for quality, for example, changes in the firm and its environment, applicable law, regulation or relevant ethical requirements.
- Information relevant to establishing the quality objectives, identifying and assessing the quality risks and designing responses, for example, the types of services the firm provides, the industries it serves and the entities to whom services are provided or, when the firm operates as part of a network, the information obtained from the network in relation to the services that the network provides.
- Information relevant to the operation of the responses identified, including information obtained from engagement teams, for example, information regarding the financial interests of the firm's personnel that enables the firm to identify and evaluate threats to the firm's independence, information communicated by an engagement team regarding non-audit services provided to an entity or information communicated by engagement quality control reviewers.

A55. Parties that are external to the firm may include the network, network firms, external oversight authorities, users of the firm's reports, management or those charged with governance of the firm's clients, external service organizations or the firm's legal counsel. Information that is exchanged with parties that are external to the firm may include the following:

- Information about the services provided by the network, as described further in paragraphs 62–66.

- Information relating to the design, development and performance of the firm's system of quality management communicated to external oversight authorities.
- Information relating to external inspection findings that is received by the firm from external oversight authorities.
- Information related to audit quality that is communicated to the firm's stakeholders, including those charged with governance of the firm's clients (e.g., internal indicators of audit quality communicated in the firm's transparency report).
- Information relating to the firm's compliance with the requirements of professional standards and applicable legal and regulatory requirements, for example, information required by professional bodies with respect to the registration of the firm's engagement partners.
- Communication to external service organizations relating to the firm's policies or procedures.

The external parties with whom the firm communicates may be fewer in the case of a smaller firm.

- A56. Matters that may be required by law, regulation or relevant ethical requirements to be communicated include, for example, reporting identified or suspected non-compliance with laws or regulations to an appropriate authority.
- A57. In establishing an information system the firm may consider factors such as, the nature and source of the information and how it will be obtained and disseminated, the individuals within the firm with whom such information should be communicated and the frequency and manner of the communication, and the extent to which the information system needs to be supported by information technology. In the case of a smaller firm, the extent of communication may be reduced since firm personnel are more likely to perform multiple functions.
- A58. There are a variety of methods the firm may use to communicate information, for example, manuals of policies or procedures, newsletters, alerts, systems (e.g., the firm's engagement software), emails, intranet or other web-based applications, training, presentations, social media, webcasts or through one-on-one discussions. In determining the most appropriate method(s) and frequency of communication, the firm may take into consideration the nature and urgency of the information being communicated and the audience to whom the information is being communicated. In some circumstances, the firm may determine it necessary to communicate the same information through multiple methods in order to achieve the objective of the communication and in such cases the consistency of the information communicated is important to its effectiveness. In the case of a smaller firm, the communication may be undertaken in a more direct manner as there are fewer personnel with whom to communicate. In considering the method of the communication, the firm may take into consideration cultural, ethnic and generational differences in order to enable effective communication.

Complaints and Allegations

- A59. Establishing policies or procedures to deal with complaints and allegations supports the firm's internal culture that promotes a commitment to quality, including professional values ethics and attitudes. The firm's process to enable reporting of complaints and allegations may include establishing clearly defined channels for firm personnel or external parties to raise any concerns in a manner that enables them to come forward without fear of reprisal.

- A60. Complaints and allegations may originate from within or outside the firm and may relate to the failure of the work performed by the firm to comply with professional standards and applicable legal and regulatory requirements, or non-compliance with the firm's system of quality management. Complaints and allegations may be made by engagement team members, other firm personnel, clients or other third parties.
- A61. Policies or procedures established for the investigation of complaints and allegations other than those that are clearly frivolous may include, for example, that the person(s) supervising the investigation:
- Has sufficient and appropriate experience;
 - Has authority within the firm; and
 - Is otherwise not involved in the engagement or has sufficient objectivity from the area or personnel of the firm subject to the investigation.

The person(s) supervising the investigation may involve legal counsel as necessary. In the case of a small firm, it may not be practicable for the partner supervising the investigation not to be involved in the engagement or other subject matter of the investigation. As a result, such firms may use the services of an external person to carry out the investigation into complaints and allegations, for example, legal counsel or a consultant.

- A62. In investigating complaints and allegations, the firm may have a responsibility to determine whether law, regulation or relevant ethical requirements impose an obligation on the firm to report the matter to an authority outside the firm. The investigation may also indicate a deficiency in the system of quality management that would be addressed in accordance with paragraphs 55–59.

Considerations in Relation to Networks

- A63. The services provided by the network in relation to information and communication may include information systems that obtain or generate and communicate information, for example, the network may establish an information systems that records and maintains information provided by network firms in relation to independence. Paragraphs 62–66 include the considerations for the firm when using the services of a network.
- A64. There may be circumstances when the firm may determine it appropriate to report a complaint or allegation in relation to the network or another network firm, for example, the firm may identify an error in the methodology developed by the network. A complaint or allegation in relation to the network may indicate a deficiency in the firm's system of quality management that is considered in accordance with paragraphs 55–59.

Relevant Ethical Requirements (Ref: Para. 34–37)

[SECTION TO BE UPDATED TO CONSIDER THE RESTRUCTURED CODE THAT WILL BE FINALIZED BY IESBA IN DECEMBER 2017]

- A65. Relevant ethical requirements, such as the IESBA Code, establish the fundamental principles of professional ethics, which ordinarily include:
- (a) Integrity;
 - (b) Objectivity;
 - (c) Professional competence and due care;

- (d) Confidentiality; and
- (e) Professional behavior.

Such requirements generally specify how threats to compliance with the fundamental principles may be identified, evaluated and addressed and may also include requirements and application material to address specific circumstances that may arise

A66. Various aspects of the firm's system of quality management reinforce the principles in relevant ethical requirements. For example, paragraph 27(a) addresses the firm's responsibility for an internal culture that promotes a commitment to quality, including professional values ethics and attitudes, throughout the firm and emphasizing the responsibility of all firm personnel for quality in conducting engagements and performing functions in relation to the system of quality management.

Independence

A67. Relevant ethical requirements ordinarily include specific provisions addressing independence that is linked to the fundamental principles of objectivity and integrity. For example, the IESBA Code contains provisions addressing independence in relation to audits and reviews of financial statements, as well as other assurance engagements. Law or regulation in a jurisdiction may also contain provisions addressing independence, for example, in relation to mandatory tendering and rotation or the provision of non-assurance services.

A68. Paragraph 37 includes responses that the firm is required to implement in order to address quality risks in relation to independence. These responses support the firm in addressing non-compliance with independence requirements and demonstrating the importance that the firm attaches to independence. However, the firm typically designs additional responses in order to appropriately address the quality risks, for example:

- (a) Communicating the independence requirements to all firm personnel and, where applicable, others subject to independence requirements (including network firm personnel).
- (b) Establishing policies or procedures to support the communication of relevant information to appropriate parties within the firm or to the engagement partner, for example:
 - (i) Information about client engagements and the scope of services, including non-assurance services.
 - (ii) Notification of circumstances and relationships that may create a threat to independence.
 - (iii) Prompt notification of any breaches of independence.
- (c) Establishing information systems that record and maintain information in relation to independence.

A69. [PLACEHOLDER – PUBLIC SECTOR CONSIDERATIONS TO BE FURTHER DEVELOPED]
Statutory measures may provide safeguards for the independence of public sector auditors. However, threats to independence may still exist regardless of any statutory measures designed to protect it. Therefore, in designing the responses to the quality risks in relation to independence, the public sector auditor may have regard to the public sector mandate and address any threats to independence in that context.

Long Association of Personnel on an Assurance Engagement

- A70. A familiarity or self-interest threat may arise when an individual is involved in an assurance engagement over a long period of time. Relevant ethical requirements may contain provisions addressing the long association of personnel on an assurance engagement. For example, the IESBA Code includes provisions addressing the long association of personnel on an audit engagement, with specific time-on and cooling-off periods in respect of certain entities.
- A71. The responses designed and implemented by the firm ordinarily address the quality risk that arises in circumstances when there is long association of personnel on assurance engagements. Such responses may include policies or procedures that clearly establish the appropriate length of service of personnel performing assurance engagements, taking into consideration the requirements of relevant ethical requirements, and may be designed appropriate to the level of the engagement team members and the nature of the engagement. For example, the length of service may be less for more senior members of the engagement team, or the firm may establish a lower period of service for engagements performed for entities that are of public interest.
- A72. [PLACEHOLDER – PUBLIC SECTOR CONSIDERATIONS TO BE FURTHER DEVELOPED] In the public sector there may be public sector entities that are significant due to size, complexity or public interest aspects, and which consequently have a wide range of stakeholders, however may not be subject to the specific time-on and cooling-off periods in the IESBA Code. Therefore, the firm may determine it appropriate to establish policies or procedures that set out the maximum length of service of personnel for such entities.
- A73. [PLACEHOLDER – PUBLIC SECTOR CONSIDERATIONS TO BE FURTHER DEVELOPED] In the public sector, legislation may establish the appointments and terms of office of the auditor with engagement partner responsibility. As a result, it may not be possible to comply strictly with the engagement partner rotation requirements envisaged for listed entities. Nonetheless, for public sector entities considered significant, it may be in the public interest for public sector audit organizations to establish policies or procedures to promote compliance with the spirit of the provisions in the IESBA Code addressing the long association of personnel.

Acceptance and Continuance of Client Relationships and Specific Engagements (Ref: Para. 38–41)

Integrity and Ethical Values of the Client, including Management, and, When Appropriate, Those Charged with Governance (Ref: Para. 39(a))

- A74. The firm's responses to consider the integrity and ethical values of the client, including management, and, when appropriate, those charged with governance, ordinarily include obtaining such information as the firm considers necessary in the circumstances before accepting and continuing the client relationship and specific engagement such as the identity and business reputation of the client's principal owners, key management, and those charged with its governance. Other matters to consider may include, for example:
- The nature of the client's operations, including its business practices.
 - Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.

- Whether the client is aggressively concerned with maintaining the firm's fees as low as possible.
- Indications of an inappropriate limitation in the scope of work.
- Indications that the client might be involved in money laundering or other criminal activities.
- The reasons for the proposed appointment of the firm and non-reappointment of the previous firm.
- The identity and business reputation of related parties.

A75. The firm may obtain the information from a variety of internal and external sources, for example:

- In the case of an existing client, consideration of significant matters that have arisen during the current or previous engagements, if applicable.
- In the case of a new client, inquiry of existing or previous providers of professional accountancy services to the client, in accordance with relevant ethical requirements.
- Discussions with other third parties, such as bankers, legal counsel and industry peers.
- Inquiry of other firm personnel.
- Background searches of relevant databases.

A76. [PLACEHOLDER – PUBLIC SECTOR CONSIDERATIONS TO BE FURTHER DEVELOPED] In the public sector, auditors may be appointed in accordance with statutory procedures. Accordingly, the firm's responses addressing the quality risks arising from the acceptance and continuance of client relationships and specific engagements may involve using the information obtained at the engagement level in performing risk assessments and in carrying out reporting responsibilities.

The Firm's Ability to Perform the Engagement (Ref: Para. 39(b))

A77. The firm's ability to perform the engagement may depend on factors such as whether the firm:

- Has the technical competence relevant to the engagement, and sufficient and appropriate knowledge of the entity's industry;
- Is capable and able to comply with relevant ethical requirements; and
- Has the time and resources to perform the engagement.

In the case of an engagement that involves the audit of group financial statements, the firm may also consider the extent to which the firm will be able to be involved in the work of component auditors.

A78. The firm's response to address the consideration of whether the firm is able to perform the engagement may involve reviewing the specific requirements of the engagement and the existing partner and staff profiles at all relevant levels, and considering whether:

- Firm personnel assigned to the engagement have appropriate technical competence, professional skills and professional values, ethics and attitudes to perform engagements, including knowledge of the relevant industry or the underlying subject matter or criteria to be applied in the preparation of the subject matter information and experience with relevant regulatory or reporting requirements, or the ability to gain the necessary skills and knowledge effectively.

- The firm has sufficient personnel with the necessary competence and capabilities.
- Experts are available, if needed.
- Individuals meeting the eligibility requirements to perform engagement quality control review are available, where applicable.
- The firm is able to complete the engagement within the reporting deadline, for example, the time available to complete the engagement may be unreasonable in relation to the reporting deadline.

Withdrawal from an Engagement (Ref: Para. 39(d))

A79. The firm's response to address circumstances when information becomes available to the firm that may indicate that withdrawal is an appropriate action may include:

- Establishing policies or procedures that set out the actions to be taken when such information becomes available, for example, appropriate consultation within the firm or with legal counsel;
- Considering whether there is a professional, legal or regulatory requirement for the firm to remain in place, or for the firm to report the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities.
- Discussing with the appropriate level of the client's management and those charged with its governance the appropriate action that the firm might take based on the relevant facts and circumstances, and when it is determined that withdrawal is an appropriate action, informing them of this decision and the reasons for the withdrawal.

Resources (Ref: Para. 42–45)

A80. Resources at the firm level include:

- Financial resources that are available to the firm.
- Human resources who have appropriate competence and capabilities.
- Technological resources, for example, application systems and hardware.
- Intellectual resources, for example, the firm's development of a methodology or guides

A81. The firm's financial resources are ordinarily funded through the fees obtained from the services performed by the firm. Sections XX of the IESBA Code [TO BE REFERENCED ONCE RESTRUCTURE IS FINALIZED] explain the threats to compliance with the principles of integrity and professional competence and due care in relation to fees, for example, how the level of the fees, the relative size of the fee in the context of all of the fees earned by the firm for all engagements or overdue fees may create threats to such compliance.

A82. In performing engagements, a variety of resources are used, including human resources, technological resources and intellectual resources. The nature and extent of resources used in the performance of engagements may vary across the firm, and are influenced by a variety of factors, for example, the nature of the engagements or the type of entities for whom the engagements are performed.

Human Resources (Ref: Para. 43(b)–43(d))

A83. Attracting, developing and retaining human resources ordinarily involves the following processes:

- Recruitment.
- Performance evaluation.
- Training and continuing professional development.
- Career development and promotion.
- Compensation.

Recruitment strategies that support the firm's system of quality management may include a focus on selecting individuals of integrity who have the ability to develop the technical competence, professional skills and professional values, ethics and attitudes necessary to perform engagements and other functions within the firm and who possess the appropriate characteristics to enable them to perform.

A84. The International Education Standards establish requirements addressing the initial professional development and continuing professional development of professional accountants and further address the professional competence for engagement partners performing audits of financial statements. These standards include the attributes of the professional accountant or engagement partner, including appropriate technical competence, professional skills and professional values, ethics and attitudes to perform engagements. Developing these attributes across all firm personnel may involve actions such as:

- Recruiting personnel with the appropriate competence and experience or sourcing suitably qualified external person(s) when internal resources are not available.
- Encouraging and supporting employees in undertaking professional education.
- Establishing policies or procedures addressing continuing professional development for all firm personnel.
- Providing continuous training resources and assistance.
- Allocating personnel to obtain particular work experience.
- Coaching by more experienced staff, for example, through direction, supervision and review by members of the engagement team.
- Independence education for personnel who are required to be independent.

A85. When assigning personnel to engagements or other roles, the firm may organize its personnel, including their geographical location, in a variety of ways. For example, the firm may determine that specific tasks that are repetitive in nature can be performed by a group of appropriately skilled personnel in one location, such as a shared service center. In some circumstances, the firm may determine it appropriate to obtain specialist skills from other network firms or third party service providers, such as other professional services firms. The requirements of this ISQC with respect to human resources apply to all personnel employed by the firm, for example, establishing appropriate technical competence, professional skills and professional values, ethics and attitudes.

A86. The firm may establish various mechanisms to assign personnel to engagements. For example, the firm may establish systems to monitor the workload and availability of firm personnel, including

engagement partners and engagement quality control reviewers. The firm may also establish contingency plans for addressing circumstances when unexpected events occur or matters arise that may create the need for additional human resources.

A87. In assigning personnel to engagements and determining the level of supervision required, the firm may consider, for example, the engagement team's:

- Understanding of, and practical experience with, engagements of a similar nature and complexity through appropriate training and participation;
- Understanding of professional standards and applicable legal and regulatory requirements;
- Technical knowledge and expertise, including knowledge of relevant information technology;
- Knowledge of relevant industries in which the clients operate;
- Ability to apply professional judgment; and
- Understanding of the firm's system of quality management.

A88. Given the importance of the role of the engagement partner, it may be appropriate for the firm to communicate the identity and role of the engagement partner to key members of client management and those charged with governance. Appropriate technical competence, professional skills and professional values, ethics and attitudes enhances the authority of the individual(s) assigned responsibility for performing the engagement and supports their understanding of how to fulfill their responsibilities in accordance with professional standards.

A89. Performance evaluation, compensation and promotion procedures are intended to give due recognition and reward to the development and maintenance of technical competence, professional skills and professional values, ethics and attitudes, including a commitment to quality. Steps a firm may take in developing and maintaining technical competence, professional skills and professional values, ethics and attitude include:

- Making personnel aware of the firm's expectations regarding performance, responsibility for quality and ethical principles;
- Providing personnel with an evaluation of, and counseling on, performance, progress and career development; and
- Helping personnel understand that advancement to positions of greater responsibility depends, among other things, upon performance quality and adherence to ethical principles, and that failure to comply with the firm's policies or procedures may result in disciplinary action.

Smaller firms may employ less formal methods of evaluating the performance of their personnel.

Technological Resources (Ref: Para. 43(e))

A90. The technology needed by the firm to support the operation of the firm's system of quality management and the performance of engagements may vary depending on the size of the firm, its environment and the nature of engagements performed by the firm. For example, larger firms may have technology that is developed internally or by their network and may have internal resources that provide technology support, while smaller firms may purchase software from third party service providers and use third party service providers to provide technology support. Third party service providers may also be used for the purposes of data storage.

- A91. The technology used by the firm encompasses the infrastructure and other resources in order for such technology to be able to operate, for example, human resources to operate the technology, a network infrastructure, data storage, data transmission, hardware, backup and recovery procedures and disaster recovery plans. The frequency with which the firm needs to track and respond to changes in its infrastructure depends on how rapidly the firm may be impacted by technological changes.
- A92. The purpose of the security over the firm's technology is to restrict access to the firm's technology, including the underlying data, in order to protect the data and to ensure that technology is protected from unauthorized changes. Security may include restriction of access to the underlying data, software, operating system and network, as well as restriction of access in the development of internal technology (e.g., internally developed software or applications). Security may also include restrictions on physical access. Security extends to all parties with whom the firm may exchange information or data, including the firm's network, shared service centers, third party service providers or other parties used by the firm (e.g., experts used in the performance of engagements). Threats to the firm's security may vary depending on the size and complexity of the firm, for example, larger and more complex firms may have significant amounts of data transfer and storage and therefore may have an increased risk associated with the loss of data. Furthermore, firms that perform engagements for entities that have a large and wide range of stakeholders, for example, entities whose shares are traded publicly, may have a higher risk of security breach.
- A93. The firm may develop technology internally, acquire technology from a third party service provider, or the firm's network may provide technology. The frequency with which the firm may need to acquire, develop or maintain its technology and the nature of the technology acquired may vary depending on the circumstances of the firm or the engagements performed by the firm. For example, the firm may perform audits of financial statements for entities that have highly sophisticated information technology systems and it may be more effective for the firm to use data analytical tools to perform the engagement, which may need to be updated frequently in response to changes in the entities' systems.
- A94. In circumstances when the firm acquires a technology from a third party provider or uses a technology provided by the firm's network, the firm's responses addressing how the technology is acquired and maintained may include:
- Evaluating whether the technology will meet the firm's needs and understanding the limitations of the technology.
 - Enquiring about user experiences in using the technology, for example, common errors or functionality issues.
 - Understanding how the technology is developed, tested and maintained.
 - Establishing terms of support with the technology provider, including agreeing on the frequency of updates and maintenance.
 - Understanding the responsibilities of the firm in order to effectively implement the technology, including whether additional tailoring is needed by the firm, user controls that the firm needs to implement to support the technology and how frequently the firm needs to accept updates.
 - In circumstances when there has been an update to the technology, understanding the nature of the changes and the extent to which these have been tested.

- Determining whether the technology complies with law or regulation, for example, data privacy laws.

A95. In circumstances when the firm develops a technology internally, the responses addressing how the technology is developed and maintained may include establishing policies or procedures addressing:

- The design and implementation of the technology.
- Testing of the technology and approvals for the use of the technology.
- Changes and maintenance of the technology, including testing of the changes.
- Documentation relating to the development, implementation and maintenance of the technology.
- Compliance with law or regulation, for example, data privacy laws.

A96. In order to use the firm's technology, engagement teams may be required to undertake specific actions so that such technology is used appropriately in the circumstances. For example, in some instances the firm's audit software may require that the engagement team complete certain information accurately to generate an audit file for the circumstances of the engagement, or in using the firm's data analytical tool the engagement team may need to test the underlying data.

Intellectual Resources (Ref: Para. 43(f))

A97. Intellectual resources comprise the information the firm uses to promote consistency in the performance of engagements, for example, a methodology, industry or subject matter-specific guides, standardized documentation or access to information sources (e.g., subscriptions to websites that provide in-depth information about entities or other information that is typically used in the performance of engagements). The firm may develop intellectual resources internally or may acquire intellectual resources externally, for example, from a third party service provider or the firm's network may provide intellectual resources. The nature and extent of the firm's intellectual resources may vary widely, due to the nature of engagements performed by the firm and the nature of entities for whom the engagements are performed. For example:

- Firms that perform audits of financial statements may need to develop a methodology that addresses matters such as how materiality and sample sizes are determined, whereas firms that only perform compilation engagements or agreed upon procedures may not need such methodologies.
- Firms that perform engagements of entities with complex accounting estimates may need access to a variety of information sources to support engagement teams in performing procedures in relation to such estimates.

A98. The responses addressing intellectual resources may include:

- Policies or procedures addressing the development of the intellectual resource in the case when this is developed internally.
- Understanding the responsibilities of the firm in using the intellectual resource when this is obtained externally, for example, whether additional tailoring is needed by the firm.
- Review and approval of the intellectual resource to determine that it complies with professional standards and applicable legal and regulatory requirements and is appropriate for use.

- Establishing how the intellectual resource will be maintained in response to changes in professional standards and applicable legal and regulatory requirements or changes in the firm's needs, including how such changes will be communicated throughout the firm.
- Specifying the documentation in relation to the intellectual resource, for example, documentation of the methodology.

Engagement Performance (Ref: Para. 46–49)

Direction, Supervision and Review (Ref: Para. 47(a))

A99. Appropriate teamwork and training assist less experienced members of the engagement team to clearly understand the objectives of the assigned work.

A100. Responsibilities in relation to engagement supervision may include the following:

- Tracking the progress of the engagement;
- Considering the competence and capabilities of individual members of the engagement team, whether they have sufficient time to carry out their work, whether they understand their instructions and whether the work is being carried out in accordance with the planned approach to the engagement;
- Addressing significant matters arising during the engagement, considering their significance and modifying the planned approach appropriately; and
- Identifying matters for consultation or consideration by more experienced engagement team members during the engagement.

A101. A review may involve the consideration of whether:

- The work has been performed in accordance with professional standards and applicable legal and regulatory requirements;
- Significant matters have been raised for further consideration;
- Appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- There is a need to revise the nature, timing and extent of work performed;
- The work performed supports the conclusions reached and is appropriately documented;
- The evidence obtained is sufficient and appropriate to support the report; and
- The objectives of the engagement procedures have been achieved.

Consultation (Ref: Para. 47(b))

A102. Consultation may assist in promoting quality in the performance of engagements as it is intended to support the application of professional judgment by the engagement team. The firm's emphasis on the importance of consultation, including encouraging firm personnel to consult on difficult or contentious matters and recognizing that consultation is a strength, may assist in promoting the firm's internal culture that reinforces a commitment to quality.

A103. Consultation typically involves a discussion at the appropriate professional level, with individuals within or outside the firm who have specialized expertise. Accordingly, in considering its resource needs, the firm may take into consideration the resources needed to support consultation, including access to appropriate research resources and human resources with the technical competence, professional skills and professional values, ethics and attitudes that enable them to appropriately consult. In some instances, such as a smaller firm, resources to support consultation may only be available externally, for example other firms, professional and regulatory bodies, or commercial organizations that provide such services, and the firm may consider whether the external provider is suitably qualified to provide appropriate consultation.

A104. Effective consultation on significant technical, ethical and other matters is likely to be achieved when those consulted:

- Are given all the relevant facts that will enable them to provide informed advice; and
- Have appropriate knowledge, seniority and experience,

and when conclusions resulting from consultations are appropriately documented and implemented.

A105. Documentation of consultations with other professionals that involve difficult or contentious matters that is sufficiently complete and detailed typically contributes to an understanding of:

- The issue on which consultation was sought; and
- The results of the consultation, including any decisions taken, the basis for those decisions and how they were implemented.

Differences of Opinion (Ref: Para. 47(c))

A106. In order to effectively deal with or resolve differences of opinion, the firm may determine it appropriate to establish policies or procedures that encourage identification of differences of opinion at an early stage, provide clear guidelines as to the successive steps to be taken thereafter, and require documentation regarding the resolution of the differences and the implementation of the conclusions reached. Procedures to resolve such differences may include consulting with another practitioner or firm, or a professional or regulatory body.

Engagement Documentation (Ref: Para. 47(d))

Completion of the Assembly of Final Engagement Files

A107. Law or regulation may prescribe the time limits by which the assembly of final engagement files for specific types of engagement is to be completed. Where no such time limits are prescribed in law or regulation, the firm ordinarily establishes a time limit that reflects the need to complete the assembly of final engagement files on a timely basis. In the case of an audit, for example, such a time limit would ordinarily not be more than 60 days after the date of the auditor's report.

A108. There may be circumstances when two or more different reports are issued in respect of the same subject matter information of an entity, and such reports are generally considered separate engagements for the purpose of the completion of the engagement file. This may, for example, be the case when the firm issues an auditor's report on a component's financial information for group consolidation purposes and, at a subsequent date, an auditor's report on the same financial information for statutory purposes.

Confidentiality, Safe Custody, Integrity, Accessibility and Retrievability of Engagement Documentation

A109. Relevant ethical requirements generally establish an obligation for the firm's personnel to observe at all times the confidentiality of client information, unless specific client authority has been given to disclose information, or there are responsibilities under law, regulation or relevant ethical requirements to do so.¹⁰ Specific laws or regulations may impose additional obligations on the firm's personnel to maintain client confidentiality, particularly where data of a personal nature are concerned. Client information may be contained in engagement documentation or other locations, such as emails, firm servers or hard copy. Accordingly, the firm's responses to address the confidentiality of client information may need to address all possible locations of client information.

A110. Whether engagement documentation is in paper, electronic or other media, the integrity, accessibility or retrievability of the underlying data may be compromised if the documentation could be altered, added to or deleted without the firm's knowledge, or if it could be permanently lost or damaged. Accordingly, responses that the firm may design and implement to avoid unauthorized alteration or loss of engagement documentation include those that:

- Enable the determination of when and by whom engagement documentation was created, changed or reviewed;
- Protect the integrity of the information at all stages of the engagement, especially when the information is shared within the engagement team or transmitted to other parties via the internet;
- Prevent unauthorized changes to the engagement documentation; and
- Allow access to the engagement documentation by the engagement team and other authorized parties as necessary to properly discharge their responsibilities.

A111. Examples of responses that the firm may design and implement to maintain the confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation include:

- The use of a password among engagement team members to restrict access to electronic engagement documentation to authorized users.
- Appropriate back-up routines for electronic engagement documentation at appropriate stages during the engagement.
- Procedures for properly distributing engagement documentation to the team members at the start of the engagement, processing it during engagement, and collating it at the end of engagement.
- Procedures for restricting access to, and enabling proper distribution and confidential storage of, hardcopy engagement documentation.

Retention of Engagement Documentation

A112. The needs of the firm for retention of engagement documentation, and the period of such retention, may vary with the nature of the engagements performed by the firm and the firm's circumstances, for example, whether the engagement documentation is needed to provide a record of matters of continuing significance to future engagements. The retention period may also depend on other

¹⁰ See, for example, Section 140.7 and Section 225.35 of the IESBA Code.

factors, such as whether local law or regulation prescribes specific retention periods for certain types of engagements, or whether there are generally accepted retention periods in the jurisdiction in the absence of specific legal or regulatory requirements.

A113. In the specific case of audit engagements, the retention period would ordinarily be no shorter than five years from the date of the auditor's report, or, if later, the date of the group auditor's report.

A114. Responses that the firm designs and implements in relation to the retention of engagement documentation may address:

- The retrieval of, and access to, the engagement documentation during the retention period, particularly in the case of electronic documentation since the underlying technology may be upgraded or changed over time;
- Recording changes made to engagement documentation after the engagement files have been completed; and
- External persons who may be authorized to access and review specific engagement documentation, as appropriate to the circumstances.

Ownership of engagement documentation

A115. Unless otherwise specified by law or regulation, engagement documentation is the property of the firm. The firm may, at its discretion, make portions of, or extracts from, engagement documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the firm or its personnel.

Engagement Quality Control Reviews (Ref. Para: 49)

[PLACEHOLDER TO DEMONSTRATE HOW ENGAGEMENT QUALITY CONTROL REVIEWS MAY BE INCORPORATED IN THE STANDARD. THE APPLICATION MATERIAL BELOW IS NOT FOR DISCUSSION AT THE DECEMBER 2017 IAASB MEETING]

A116. Law or regulation may require an engagement quality control review for engagements other than audits of listed entities, for example, audits of financial statements of entities:

- That are characterized in such law or regulation as public interest entities;
- Operating in the public sector;
- That operate in certain industries, for example, banks, insurance companies and pension funds;
- That meet an asset threshold determined by law or regulation;
- That are under judicial management; or
- That are recipients of a government grant.

A117. Characteristics of other engagements for which the firm may determine that an engagement quality control review is an appropriate response may include:

- Engagements performed by the firm for entities that may be of significant public interest because of the nature and size of the business or because they have a large number and wide range of stakeholders. Examples of such entities may include financial institutions (such as banks, insurance companies and pension funds), entities that are undergoing, or plan to undergo, an initial public

offering and other entities for which the report may be widely distributed (such as charities, entities operating in the public sector or that are supported by public funding, or entities that have a substantial number of employees or members). In some circumstances, entities that may be of significant public interest may be characterized in law or regulation as public interest entities.

- Engagements that involve a high level of complexity or judgment or where previous issues have been encountered on the engagement, for example:
 - A history of misstatements or deficiencies in internal controls, significant internal or external inspection findings, a material restatement of comparative information in the financial statements or an auditor's report that required reissuance.
 - Circumstances when there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.
- The identification of unusual circumstances or risks in an engagement or class of engagements (e.g., risks identified as part of the firm's client acceptance process or engagements in a certain industry sector).
- Engagements with quality risks associated with the composition of the engagement team, for example, long association of a senior engagement team member or a newly appointed engagement partner.

In some cases, the firm may determine that there are no engagements for which an engagement quality control review is an appropriate response, for example, in the case of a firm that performs engagements for small entities.

A118. There may be circumstances when the firm determines that an engagement quality control review should be performed for an engagement that is not within the scope of the firm's policies or procedures. Regardless of the circumstances in which the firm determines an engagement is to be subject to an engagement quality control review, the requirements of ISQC 2 apply.

Considerations Specific to Public Sector Audit Organizations

A119. Listed entities are not common in the public sector. However, there may be other public sector entities that are significant due to size, complexity or public interest aspects, and which consequently have a wide range of stakeholders. Examples include state owned corporations and public utilities. Ongoing transformations within the public sector may also give rise to new types of significant entities. There are no fixed objective criteria on which the determination of significance is based. Nonetheless, public sector auditors evaluate which entities may be of sufficient significance to warrant performance of an engagement quality control review.

Monitoring and Remediation Process

Establishing a Monitoring and Remediation Process (Ref: Para. 50)

A120. In addition to supporting the firm's evaluation of the design and operation of the components of the firm's system of quality management, the monitoring and remediation process facilitates the improvement of engagement quality and the firm's system of quality management.

A121. A monitoring and remediation process typically involves the following steps:

- Design the monitoring activities, i.e., the nature, scope and frequency of such activities;

- Implement the internal monitoring activities;
- Evaluate the results of the monitoring activities and external inspections, and consider any other relevant information;
- Address deficiencies identified if there is an indication that a report may be inappropriate or that procedures were omitted during the performance of an engagement
- Investigate the root cause(s) of deficiencies
- Evaluate the effect of deficiencies;
- Implement appropriate remedial action(s);
- Evaluate the effectiveness of the remedial actions; and
- Communicate matters in relation to the monitoring and remediation process.

Monitoring the Firm's System of Quality Management (Ref: Para. 51–52)

A122. In order for the objective of the firm's system of quality management to be achieved, the firm is required to design and operate each component in accordance with this ISQC in an integrated manner.

A123. The assessed quality risks and the design of the responses may influence the nature, scope and frequency of the monitoring activities, for example, the firm may more frequently monitor areas of higher assessed quality risk or extend the scope of monitoring in such areas. Other factors that may also affect the nature, scope and frequency of the monitoring activities include:

- The size of the firm, the types of services the firm provides, the industries it serves and the nature of the entities to whom services are provided.
- The structure and organization of the firm, including the involvement of the network firm in monitoring activities.
- The firm's infrastructure, for example, technology and resources to support monitoring activities.

A124. The frequency of the firm's monitoring activities may comprise ongoing monitoring activities, periodic monitoring activities or a combination of both. Ongoing monitoring activities are generally routine activities, built into the firm's processes and performed on a real-time basis, reacting to changing conditions, for example, computerized continuous monitoring techniques over engagement file retention procedures. Periodic monitoring activities are conducted at certain intervals by the firm, for example, inspection of completed engagements. Since periodic monitoring activities are performed at certain intervals, ongoing monitoring activities may be more effective in identifying deficiencies in the system of quality management in a timely manner. Nevertheless, periodic monitoring activities may be useful in confirming the results of ongoing monitoring activities.

A125. Certain responses to the quality risks may be designed to detect deviations in the system of quality management in order that such deviations are promptly corrected. For example, the firm may implement activities to detect breaches of the firm's independence policies or procedures. Since the activity is designed as a response to a quality risk, the firm may implement monitoring activities to evaluate the design and implementation of the response. In such cases, the response is not typically a monitoring activity, since the firm does not typically evaluate whether such deviations are

deficiencies in the system of quality management (i.e., the response is designed to detect and correct a deviation in order to prevent deficiencies). However, such responses may affect the nature, scope and frequency of the firm's monitoring activities. For example, in response to a quality risk, the firm may require engagement teams to obtain a review of the audited financial statements and other aspects of the engagement by a central technical team prior to dating the audit report (e.g., a pre-issuance review) and depending on the extent of the pre-issuance review, it may reduce the scope or frequency of engagement inspections.

A126. Examples of how the nature, scope and frequency of the firm's monitoring activities may vary include:

- The firm's monitoring activities in relation to evaluating the governance principles may be performed periodically and less frequently than the monitoring activities in relation to engagement performance.
- The firm may determine that more frequent monitoring activities are needed in relation to certain types of engagements, for example, entities operating in industries that are subject to frequent change or engagements where a high number of deficiencies have been identified through previous monitoring activities.
- Due to the increased risk of deficiencies, the firm's monitoring activities in relation to matters related to independence may comprise ongoing activities in order that breaches of independence are identified in a timely manner, and may include automated systems to capture and monitor information. The firm may also perform periodic monitoring activities, such as inspecting personnel's financial affairs for compliance with the firm's independence policies or procedures.

A127. Examples of monitoring activities may include:

- Evaluating actions by leadership in establishing an appropriate tone at the top and culture that supports quality.
- Interviewing firm personnel to evaluate the effectiveness of the firm's communication in relation to certain matters.
- Evaluating who within the firm has been assigned responsibility for establishing the quality objectives, identifying and assessing quality risks and designing responses to the quality risks, and how such personnel have gone about doing so.
- Using peer reviews, or other types of reviews, designed with the purpose of monitoring areas of the firm's system of quality management.
- Applying automated alerts in relation to engagements, for example, automatic notifications when policies are not applied.
- Inspecting records regarding the provision of non-audit services by other service lines within the firm to establish that prohibited services were not provided to an audit client.
- Checking records of attendance at training events for compliance with the firm's policies on professional development.
- Inspecting time records for (i) number of hours spent by engagement partners and other senior personnel and assessing the appropriateness of such hours; or (ii) evidence of involvement of

experts on certain types of engagements such as audits performed in respect of certain industries, to determine the appropriate use of experts.

- In the case of a smaller firm, as a result of the close oversight of the firm, periodic consideration of matters such as whether:
 - The firm's communication appears effective, based on the daily interactions with firm personnel; or
 - Staff have complied with the firm's policies or procedures on engagement acceptance and continuance.

A128. The monitoring and remediation process is designed to evaluate the design and operation of each of the components of the system of quality management. This includes the monitoring and remediation process itself, since an evaluation of this component is necessary in determining whether deficiencies exist in the component and whether such deficiencies are major deficiencies. The firm's evaluation of the design and operation of the monitoring activities may involve, for example:

- Considering whether there are certain monitoring activities that are identifying shortcomings which should have been identified by other monitoring activities.
- Considering other information that may indicate deficiencies in the monitoring and remediation process, for example, external inspection findings, network inspections or complaints and allegations.
- Firm leadership understanding the monitoring activities undertaken and evaluating whether they appear adequate to support an evaluation of the firm's system of quality management.
- Activities designed to monitor the monitoring activities, for example, a pre-issuance review may be designed to monitor compliance with certain policies or procedures, and the firm may monitor such pre-issuance review as part of its periodic inspections of completed engagements.
- Understanding the root cause(s) of deficiencies, i.e., the firm may identify a shortcoming in the monitoring activities through understanding the root cause(s).

A129. The firm's system of quality management may change as a result of, for example:

- Changes in the internal and external factors that affect the various components (e.g., a new service offered by the firm or changes in the firm's environment).
- Changes to address an identified deficiency in the firm's system of quality management.
- Other factors, such as the firm amends the responses to quality risks because these become obsolete over time or more effective responses are designed and implemented

When changes occur, previous monitoring activities undertaken by the firm may no longer provide the firm with information to support the evaluation of the components of the system of quality management and therefore the firm's monitoring activities may include monitoring areas of change. Furthermore, previous monitoring activities undertaken by the firm may also no longer provide the firm with information to support the evaluation of the components of the system of quality management in relation to areas that have remained the same, for example, because of the time period since the monitoring activities were undertaken. Accordingly, the firm may need to consider the relevance of previous monitoring activities, which includes understanding changes in factors that

impact the firm's system of quality management, as well as when such monitoring activities were performed.

A130. The outcome of the firm's previous monitoring activities may also indicate areas where monitoring activities should be undertaken, for example, monitoring may need to be undertaken in certain areas where there is a history of deficiencies. The firm may also obtain other information that may suggest deficiencies in the firm's system of quality management and therefore may indicate the need for the firm to conduct monitoring activities, for example, the firm may conduct monitoring activities in response to the results of external inspection findings in order to further understand such findings and their effect on the firm. Similarly, the firm may determine it appropriate to perform monitoring activities in circumstances when there is a material restatement of financial statements or an engagement report requires reissuance.

Engagement Inspections (Ref: Para. 53)

A131. In considering which engagements may be subject to inspection, the firm may take into consideration criteria such as:

- Engagements when the firm or engagement partner are inexperienced, for example, a new industry, a new service offering or new engagement partner.
- The inspection of particular engagements on a more regular basis, for example, engagements performed in respect of certain entities (e.g., a listed entity).
- Engagements subject to external inspection that have negative findings, or engagements where the results of previous internal inspections identified deficiencies.
- Engagements where there has been a material restatement of comparative information in the financial statements or the firm's report required reissuance.

A132. The criteria are required to include the inspection of at least one completed engagement for each engagement partner, on a cyclical basis determined by the firm. For example, the firm may determine that the cyclical period for an engagement partner performing audits of financial statements may be three years. The frequency of selection of individual engagement partners or individual engagements, depends on many factors, such as the following:

- The nature of the engagements provided by the firm, for example, the firm may establish different cycles for different types of engagements.
- The size of the firm, including the number and geographic location of offices and the nature and complexity of the firm's practice and organization, for example, the firm may consider how many engagement inspections are needed that would provide an adequate sample to support the firm's evaluation of the system of quality management.
- The nature and extent of other monitoring procedures implemented by the firm.
- The nature and extent of responses implemented by the firm to address quality risks, for example, pre-issuance reviews that are designed to detect, correct and prevent deficiencies may reduce the need for engagement inspections.

A133. Evaluating completed engagements ordinarily involves performing procedures designed to provide evidence of compliance by engagement teams with the aspects of the firm's system of quality management relevant to the engagement. In determining the nature and extent of the procedures to

be undertaken in performing the evaluation of completed engagements, the firm may consider a variety of factors, for example, the assessment of quality risks or areas of change in the firm's system of quality management (e.g., circumstances when the firm has introduced a new policy or procedure). Such procedures may also include performing substantive reviews of the quality of work performed, in particular in relation to significant judgments made by the engagement team and the related conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report.

Objectivity of Those Performing Monitoring Activities (Ref: Para. 54(b))

A134. The determination of whether those performing monitoring activities are sufficiently objective depends on the activity subject to monitoring. For example, an activity involving the exercise of judgment may necessitate heightened objectivity by those performing the monitoring activities than activities with no judgment. In some circumstances, the monitoring activities in relation to an activity that is automated could be undertaken by those involved with the activity (e.g., the monitoring of the firm's automated process for identifying breaches of the firm's independence policies or procedures). In considering the objectivity of those performing the monitoring activities, the firm may take into consideration the relevant ethical requirements that may set out a framework in addressing a threat to objectivity.

Identifying and Remediating Identified Deficiencies

Evaluating the Results of the Monitoring Activities and External Inspections and Consideration of any other Relevant Information (Ref: Para. 55)

A135. A deficiency in the system of quality management occurs when a shortcoming is identified by the firm through its monitoring activities, external inspections or other information, and the firm determines that such shortcoming reduces the likelihood that a quality objective(s) is achieved. The quality objectives in relation to the quality management process and the monitoring and remediation process are embedded in the requirements set out in this ISQC in relation to these components.

A136. Not all shortcomings are necessarily deficiencies. In determining whether a deficiency exists, the firm may consider the nature of the shortcoming and whether it is systemic. For example, a shortcoming may be identified across many engagement inspections that, individually, may not be considered significant. However in aggregation, these shortcomings may be more systemic and pervasive, thereby may indicate that a deficiency exists.

A137. While the monitoring and remediation process in this ISQC focuses on deficiencies, the monitoring activities, external inspections or other information may also provide information regarding opportunities for the firm to improve, or further enhance, the system of quality management. Furthermore, as part of understanding the results of monitoring activities, external inspections or other information, in particular the root cause(s) of deficiencies, it may be useful for the firm to also understand those areas of the system of quality management where no deficiencies have been identified. For example, in performing inspections of completed engagements, the firm may identify engagements with very few, if any deficiencies and it may be useful to understand the circumstances surrounding such engagements.

A138. Other relevant information may arise from sources such as the firm's complaints and allegations or the firm's network may provide information that may indicate deficiencies. The results of external inspections may either indicate deficiencies, or such results may highlight information that may be

relevant to the firm in designing and implementing its monitoring activities. Furthermore, external oversight authorities may also provide information about themes from their inspections of firms within their remit that may be useful for the firm to consider in relation to its system of quality management.

Deficiencies (Ref: Para. 56)

A139. In circumstances when the report issued is inappropriate or procedures were omitted, the procedures undertaken by the firm are intended to address the specific engagement and the firm's risk associated with an inappropriate report or omitted procedures. If the shortcoming is considered to be a deficiency, the root cause(s) of such deficiency still is required to be investigated and remediated. For example, when performing an inspection of a completed engagement, it is identified that the engagement team failed to perform a procedure and the firm determines it appropriate in the circumstances to inform those charged with governance of the matter and to undertake the procedures that were not performed. However, the firm still needs to investigate why the engagement team did not perform the procedure, for example, it may have been as a result of a lack of sufficient time to undertake the engagement.

Investigating the Root Cause of Deficiencies (Ref: Para. 57)

A140. The objective of investigating the root cause(s) of deficiencies is to understand the underlying circumstances that caused the deficiencies. An improved understanding of the underlying cause(s) of deficiencies may:

- Facilitate the implementation of more effective actions to address deficiencies, thereby improving quality.
- Directly contribute to the improvement of quality at the engagement level through the participation of engagement teams in the root cause analysis process.
- Enable those assigned ultimate or operational responsibility for the system of quality management to have an improved awareness, to enable them to proactively monitor actions taken to address deficiencies.
- Facilitate more effective communication to firm personnel by explaining the actual root cause(s) of deficiencies, rather than the deficiencies themselves.

A141. Performing a root cause analysis generally involves those performing the assessment applying judgment based on the evidence available. The firm's process for investigating the root cause may be simple in circumstances when:

- The root cause(s) of a deficiency is apparent due to the nature of the deficiency; or
- The perceived severity of the deficiency is not significant and therefore the firm may not undertake a complex process to understand the root cause(s).

In other circumstances, the firm's process for investigating the root cause(s) of a deficiency may be more complex and may include:

- Identifying those responsible for performing the root cause analysis, and establishing their competency to do so, including providing training on how to effectively investigate the root cause(s).
- Determining the nature, timing and extent of the root cause analysis.

- Conducting interviews of engagement teams and others, in order to gain insight into what may have caused the deficiency.
- Evaluating the evidence and other information available and identifying the root cause(s) based on such evidence.

A142. The firm may perform a trend analysis in order to assist with investigating the root cause(s) of a deficiency. Trend analyses may also be used by the firm in relation to those shortcomings identified by the firm through its monitoring activities, external inspections or other information, that the firm has not determined are deficiencies. In some circumstances, such analyses may indicate that a deficiency exists, particularly when it is identified that a shortcoming is pervasive or systemic.

A143. The underlying root cause(s) of deficiencies may relate to a variety of factors and there may be many root causes that relate to a particular deficiency. Furthermore, the root cause of a deficiency may relate to more than one component, for example, a deficiency related to compliance with relevant ethical requirements may relate to a firm culture that does not promote ethical values. In particular, in circumstances when the root cause relates to an aspect of the firm's quality management process, such root cause may affect multiple components, for example, if the firm's process for identifying risks is defective, this may affect all of the components.

A144. Examples of root causes in relation to the various components of the system of quality management include:

- The purpose and values of the firm, as well as the expected behaviors of the firm's personnel are not well defined.
- The firm fails to communicate information to engagement teams.
- A risk to a quality objective is not identified by the firm and therefore there is no response designed and implemented to address the quality risk.
- Resources to support the firm's quality management or engagement teams are inappropriate, for example, the methodology or software is outdated.
- Incentives established for firm personnel promote financial considerations to the detriment of quality.
- The firm culture does not promote consultation on difficult issues or the firm's process for addressing differences of opinion is not clear or well established.
- The firm acceptance procedures are not followed and the firm accepts a client that lacks integrity, or the firm accepts an audit engagement and the firm does not have personnel with the necessary industry expertise to perform the engagement.
- Engagement team members have insufficient knowledge of the firm's methodology due to a lack of training.
- Firm personnel knowingly breach the firm's policies or procedures or disregard professional standards.
- The time and resources allocated to perform an engagement is insufficient.
- Engagement team members do not effectively communicate with others involved in the audit, e.g., in the case of a group audit.

- There is an absence of cooperation and open dialogue with management and those charged with governance, or the engagement team fails to discuss their needs with management and agree an appropriate timetable.
- The firm operates in a jurisdiction where cultural expectations prevent less experienced engagement team members from challenging individuals with more authority (e.g., the engagement partner or client management).

A145. Identifying a root cause(s) that is sufficiently specific may support the firm's process for appropriately remediating deficiencies and achieving the objective of this ISQC. For example, it may be identified that an engagement team inappropriately applied professional skepticism, however the underlying root cause may relate to the cultural environment, in which engagement team members typically do not challenge individuals with greater authority.

A146. In some circumstances, in investigating the root cause(s) of the deficiency, the firm may determine that:

- The quality management process is not appropriately designed or operated to establish objectives, identify and assess quality risks and design and implement responses; or
- The quality objectives, quality risks or responses within a component need to be reconsidered.

Implementing Appropriate Remedial Actions (Ref: Para. 58(a))

A147. The remedial actions are required to be responsive to the root cause(s) identified, for example, if the root cause relates to the firm having insufficient time and resources to perform the engagement, the remedial actions may include implementing additional resources or withdrawing from the engagement. The nature, timing and extent of remedial actions may depend on a variety of other factors, including:

- The impact of the root cause(s), for example, whether it relates to an individual engagement, a certain category of engagements, or is more pervasive throughout the firm.
- The severity of the deficiency, including whether it is a major deficiency, and therefore the urgency in which it needs to be addressed.
- The effectiveness of the remedial actions in addressing the root cause(s), for example, the firm may need to implement more than one remedial action in order to effectively address the root cause(s), or may need to implement remedial actions as interim measures until such time as the firm is able to implement more effective remedial actions.

Evaluating the Effect of Deficiencies (Ref: Para. 58(b))

A148. In evaluating whether a deficiency, individually or in combination with other deficiencies, is a major deficiency, the firm determines whether a deficiency, individually or in combination with other deficiencies, severely reduces the likelihood that:

- (a) The objective of a component is met; or
- (b) The components operate together.

The existence of a major deficiency may indicate that the firm does not have reasonable assurance that the objective of the system of quality management is met. In such cases, the objective of the

system of quality management may not be met until such time as the major deficiency has been remediated, and the firm has determined that such remediation is effective.

Evaluating the Effectiveness of the Remedial Actions (Ref: Para. 59)

A149. Monitoring the effectiveness of remedial actions might result in the need for new or improved remedial actions to address the root cause(s), and thereby may contribute to the continual improvement of the effectiveness of the firm's system of quality management

Communicating Matters Related to the Monitoring and Remediation Process (Ref: Para. 60–61)

A150. The timing of the communication may need to be more frequent than on an annual basis. For example, if the firm identifies a major deficiency, this ISQC requires that the firm communicate the major deficiency promptly to the person(s) assigned ultimate responsibility and accountability for the system of quality management. However, the firm may also communicate the major deficiency promptly to engagement teams or personnel performing functions in relation to the operation of the firm's system of quality management, i.e., on a more timely basis than annually. Communicating remedial actions on a timely basis may support the implementation of such actions.

A151. In determining the information to be communicated in relation to the firm's monitoring activities, including the nature and extent of such communication, the firm may consider the type of information that is relevant to the particular recipients, including the information needs of the recipients, as a result of their defined roles and responsibilities. For example:

- Information communicated to engagement teams may be focused on deficiencies that have been identified at an engagement level and therefore are likely to be relevant.
- Information communicated to all firm personnel may relate to matters relevant to compliance with the firm's independence policies or procedures as such policies or procedures may apply to all firm personnel.

Communicating the root cause(s) of deficiencies may increase awareness and understanding of why deficiencies occurred, which may influence the behaviors of engagement teams and firm personnel.

A152. The communication of deficiencies to individuals other than the relevant engagement partners need not include an identification of the specific engagements concerned, although there may be cases where such identification may be necessary for the proper discharge of the responsibilities of the individuals other than the engagement partners.

Considerations in Relation to Networks (Ref. Para. 62–66)

A153. Understanding the nature of the relationship between the firm and the network may involve matters such as considering the contractual terms with the network, how the firm and the network interact and the nature of relationships and interaction with other network firms. For example, contractual terms may state that the network requires all network firms to use certain services provided by the network (e.g., the audit methodology and audit software tool developed by the network). In other cases, the firm may be able to choose to use the services provided by the network, for example, the network may offer training modules, but may not require that all network firms use such training modules.

A154. The firm obtains an understanding of the services that the network provides in order to establish if the network's services are appropriate for the firm's system of quality management, and therefore the responses address the firm's quality risks. Examples of services that the network may provide include:

- Quality objectives and quality risks developed by the network or responses designed by the network (e.g., network level policies or procedures).
- Resources, for example, audit software tools, guides or centralized technical resources; or
- Centralized processes for recording and monitoring compliance with independence requirements.

A155. The network's monitoring of the services that the network undertakes also form part of the services provided by the network, and may provide evidence to the firm that the services are operating effectively. Accordingly, if the network undertakes monitoring in relation to the network services, in addition to identifying the service, the firm also obtains the results of such monitoring activities. For example, the network may monitor the audit software tools provided by the network and remediate any deficiencies identified.

A156. In understanding the expected form, timing and content of communications between the firm and the network, the firm may take into consideration what information will be received from the network and whether the information appears relevant and reliable. The form, timing and content of communications may include the prompt communication of identified deficiencies to the firm and to appropriate individuals within the network so that the necessary action can be taken, as well as timely communication about changes to the network's services.

A157. The procedures undertaken by the firm to understand the network's process(es) may vary based on the nature of the service. For example, understanding the objectives established by the network may involve reading such objectives, however an appropriate understanding of the firm's methodology may involve requesting the network to provide an explanation about how the network has developed the methodology. The understanding of the network's processes may also include determining how the services will be monitored and remediated by the network, and how the network will communicate deficiencies in a timely manner to the network firms. In some instances, the services may only be designed at a network level, and therefore the understanding of the service may be limited to understanding its design.

A158. The understanding of the network's service(s) may indicate that such services are not designed, implemented or operated such that they can be effectively used by the firm. In such cases, the firm may either:

- Supplement such services at the firm level in order that the intended objective for which the services are used is achieved; or
- Be unable to use the services in its system of quality management.

The firm may include in its consideration information about a service provided by the network that the firm does not use, or contradictory information regarding the network services used by the firm.

A159. For many services, the firm may be expected to have a responsibility in relation to the implementation of the service, i.e., the supplementary actions. For example, in the case of implementing network developed software, the firm may need to have the appropriate technological infrastructure in place

to support the software and provide training to firm personnel (paragraphs A94–A95) set out further considerations in relation to the use of technological resources and intellectual resources obtained from a network). Similarly, the network may establish quality objectives, quality risks and responses across the network, however the firm may need to supplement them to address jurisdictional matters. The supplementary actions may also include monitoring the service at the firm level, for example, the inspection of completed engagements at the firm level may support the monitoring of certain policies or procedures established by the network.

Monitoring and Remediation Process (Ref. Para. 64–66)

A160. Paragraph 51 requires the firm to evaluate the components of the system of quality management, including monitoring and remediation, which includes services provided by the network and the monitoring of such services. The services may be monitored by the network, the firm, or a combination of both, however the remediation of the services may be concentrated at the network level. For example, the network may undertake monitoring activities at a network level in relation to a common methodology, however various monitoring activities at a firm level may support the evaluation of the methodology, including engagement inspections.

A161. When the firm uses the services provided by the network in relation to monitoring and remediation, the information obtained by the firm may include:

- A description of the monitoring procedures performed, including the scope, nature and frequency of such monitoring activities.
- Information about deficiencies, the root cause(s) of such deficiencies, their effect and remedial actions.
- The conclusions drawn from monitoring and remediation.

A162. The information provided by the firm to the network regarding deficiencies may be used by the network to remediate such deficiencies. In addition, the network may gather information from the network firms regarding the results of the firm level monitoring activities over activities at the firm level, including information obtained by the firm from external sources (e.g., the results of external inspections). The network may use such information to identify trends and common areas of deficiencies across the network, understand the root cause(s) of deficiencies and implement actions to address them, either at the network level or firm level. The network may also use the information to understand the effectiveness of the system of quality management in relation to the individual firms within the network that, to the extent possible, may be shared with other network firms for the purposes of providing information to support an understanding of the component auditors used within the network in the case of engagements performed in accordance with ISA 600.¹¹ In some instances, law or regulation in a particular jurisdiction may prevent the network from sharing information with other firms within the network, or may restrict the specificity of such information. [PLACEHOLDER FOR POTENTIAL GUIDANCE ON FURTHER ACTIONS WHEN THIS IS THE CASE]

A163. In circumstances when deficiencies are identified related to the network services, the deficiencies may affect the firm's system of quality management and are therefore considered by the firm in accordance with paragraph 55–59. In some cases the firm may determine that the remedial actions by the network are inadequate, or such remedial actions may take time to be effectively designed,

¹¹ ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

implemented and operated. In such cases, the firm may need to implement its own remedial actions to address the deficiency until such time as the network has effectively addressed the deficiency.

Documentation (Ref: Para. 67–69)

A164. Documentation provides evidence that the firm complies with this standard and law, regulation or relevant ethical requirements. It may also be useful for training personnel, ensuring the retention of organizational knowledge and providing a history of the basis for decisions made by the firm in relation to its system of quality management. 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.

A165. The form, content and extent of documentation in relation to the various aspects of the system of quality management may vary, for example, certain aspects of the system of quality management may be documented in detail, in particular aspects of the system of quality management that are relatively new or that relate to areas of greater quality risk. Documentation may also take the form of formal written manuals, or may exist in written form through informal means, for example, through e-mail communication or postings on websites. The firm applies judgment in determining the form, content and extent of documentation that is sufficient to meet the objective in paragraph 67. Factors that may affect such determination may include:

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

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 supporting a consistent understanding and application of the components of the firm's system of quality management. Nevertheless, in some cases, the firm may determine it appropriate to document such communications in order to provide evidence of the operation of each component. Information held in electronic databases may be used to evidence that the firm complies with this standard, particularly when there is a large volume of material or geographical dispersion of personnel (e.g., independence confirmations, performance evaluations and the results of monitoring). Manual methods of recording information, such as notes, checklists and forms, may also be appropriate.

A166. In some instances, an external oversight authority may establish expected documentation requirements, either formally or informally, for example, as a result of the outcome of external inspection findings.

A167. Paragraph A59 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.

A168. 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. 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.

A169. 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, to provide a history of the basis for decisions made by the firm in relation to its system of quality management.

Considerations in Relation to Networks

A170. In circumstances when the firm uses the services of a network, the firm's documentation may include the matters set out in paragraphs 62–66, including information obtained from the network and communications between the firm and the network. Such documentation may also include:

- A description of the network services and how such services address the firm's quality risks;
- The common quality objectives and quality risks established at the network level for all firms within the network; or
- The results of the monitoring activities performed at the network level, including identified root cause(s) for identified deficiencies and remedial actions implemented by the network to address root cause(s).