

Agenda Item D.1

Quality Management (Firm level): Issues Relating to Draft Proposed ISQC 1 (Revised)¹

Introduction

1. In September 2017, the QCTF presented a working draft of proposed ISQC 1 (Revised) to the CAG. Since the September 2017 meeting, the QCTF presented a first read of the proposed ED of ISQC 1 (Revised) to the IAASB in December 2017, and will be presenting a second read of the proposed ED of ISQC (Revised) to the IAASB in March 2018. This paper includes a summary of the key issues discussed with the IAASB in December 2017, and the key issues that will be presented to the IAASB in March 2018.
2. The key issues are:
 - (a) The scalability of draft proposed ISQC 1 (Revised);
 - (b) The components of the system of quality management;
 - (c) The objective of the standard;
 - (d) The quality risk assessment process;
 - (e) The overall structure of the components;
 - (f) Governance and leadership;
 - (g) Information and communication;
 - (h) Relevant ethical requirements, engagement acceptance and continuance, resources and engagement performance;
 - (i) Monitoring and remediation;
 - (j) Networks and service providers; and
 - (k) Professional judgment and professional skepticism.

The Scalability of Draft Proposed ISQC 1 (Revised)

3. The IAASB continues to encourage the QCTF to explore how to improve the applicability of proposed ISQC 1 (Revised) to a broad spectrum of firms. The QCTF recognizes the need for guidance and application material to support an understanding of the standard, however at the same time ensuring that it is of an appropriate length. The QCTF plans on further considering the appropriate location of guidance and explanatory material, for example, locating the material in the appendix to ISQC 1, creating a separate guide or publication for use by practitioners, or a combination of both. The QCTF has:
 - (a) In the interim, introduced an appendix to proposed ISQC 1 (Revised) that includes examples related to the application of the standard. The QCTF will continue to consider the proposed

¹ International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements and Related Services Engagements*

application material to identify any further material that may be relocated in an appendix or other publication.

- (b) Yet to develop additional guidance that explains how the requirements in the standard may be applied to a broad spectrum of firms (i.e., examples that demonstrate the application of the requirements to different sizes or complexity of firms).
4. In order to emphasize the scalability of the standard, the QCTF has highlighted the need to apply professional judgment in relation to the system of quality management, and various aspects of the application material specifically mention which decisions may be subject to professional judgment. The QCTF is of the view that this highlights the need for firms to consider their circumstances in designing a system of quality management that is appropriate to their circumstances.

Matters for IAASB CAG Consideration

- 1. Representatives are asked to share their views regarding whether aspects of proposed ISQC 1 (Revised) would result in a disproportionate burden on smaller firms.

The Components of the System of Quality Management

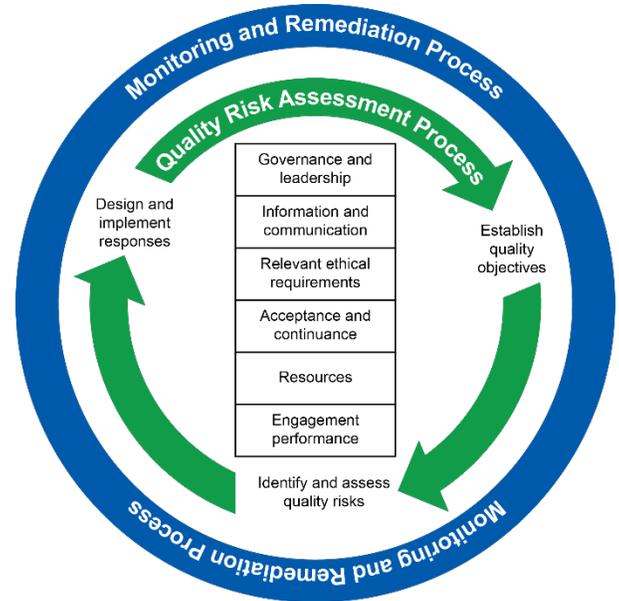
5. Since the previous discussions with the CAG, the QCTF reconsidered the appropriateness of the overall structure of ISQC 1 and the various components of the system of quality management. Various matters affected these considerations including:
- (a) The nature of the relationship between the various aspects of proposed ISQC 1 (Revised).
 - (b) The desire from the IAASB and various outreach participants to retain the elements from extant ISQC 1.
 - (c) The need for a clear relationship between proposed ISQC 1 (Revised) and proposed ISA 220 (Revised).²
 - (d) The components of a system of internal control as set out in the COSO Internal Control – Integrated Framework³ and proposed ISA 315 (Revised).⁴

² International Standard on Auditing (ISA) 220, *Quality Control for an Audit of Financial Statements*

³ Committee of Sponsoring Organizations of the Treadway Commission (COSO), *Internal Control – Integrated Framework*

⁴ ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

6. Proposed ISQC 1 (Revised) includes eight inter-related components, as depicted in the diagram. The QCTF is of the view that the eight components are appropriate, because these are necessary in establishing a system of quality management that will provide the firm with reasonable assurance that its overall objectives are met. The QCTF considered whether the components could be collapsed, but noted that the nature of the matters within the components are not similar in nature, and doing so could lose the necessary correlation with proposed ISA 220 (Revised). The table in appendix 1 summarizes the similarities between the eight components, the elements in proposed ISA 220 (Revised) and the COSO Integrated Framework.



7. As part of the restructure of proposed ISQC 1 (Revised) into the eight components, the QCTF reconsidered whether the quality risk assessment process (previously referred to as the quality management process (QMP)) should be applied to the governance and leadership component and information and communication. This would mean that quality objectives would be established, quality risks identified and assessed and responses designed and implemented in relation to these two components. Given the similarities with the risk assessment component in the COSO Integrated Framework, which applies to the control environment and information and communication, the QCTF agreed that the quality risk assessment process should be applied to all of the components, with the exception of monitoring and remediation.
8. In relation to the monitoring and remediation process, the QCTF views the requirements as prescribed responses that apply to all firms, and which are necessary to achieve a desired level of consistency across firms in monitoring and remediating their systems of quality management. In the view of the QCTF, the monitoring and remediation component may still be subject to the quality risk assessment process if the firm chooses to do so, but this is not required in the standard given the comprehensive requirements that are already established.

Matters for IAASB CAG Consideration

2. Representatives are asked to share their views regarding whether the eight components of the system of quality management are appropriate.

The Objective of the Standard

9. Since the previous CAG discussion, the QCTF has debated at length the overall objective of the standard and how to articulate this in a manner that is less compliance-focused. The QCTF also considered how, or at what level, reasonable assurance is obtained. The proposed objective of the standard is as follows:

The objective of the firm is to design, implement and operate a system of quality management that provides 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) *Engagement reports issued by the firm or engagement partners are appropriate in the circumstances.*
10. Given the feedback from the IAASB at the December 2017 meeting, the QCTF has introduced a new requirement for the individual(s) assigned ultimate responsibility and accountability for the system of quality management to perform an annual stand back and evaluate whether the system of quality management provides the firm with reasonable assurance that the firm's objective is met. The requirement also indicates that the stand back may need to be undertaken more frequently when severe or pervasive deficiencies are identified that indicate that the system may not be providing the firm reasonable assurance. The stand back would be a point-in-time assessment, i.e., it would not be for a past period because the system is designed to identify deficiencies and remediate them on an ongoing basis. The standard recognizes that there may be circumstances when the firm determines that the system does not provide it with reasonable assurance that the firm's objectives are met, for example, deficiencies exist at the time of the evaluation that are significant, and the firm has not yet remediated the deficiencies. In such cases, proposed ISQC 1 (Revised) requires the firm to communicate this fact immediately to firm personnel and if appropriate, parties that are external to the firm.

Matters for IAASB CAG Consideration

3. Representatives are asked to share their views regarding the proposal that the individual(s) assigned ultimate responsibility and accountability for the system of quality management is required to perform a stand back (annually or more frequently as appropriate) and evaluate whether the system of quality management provides the firm with reasonable assurance that the firm's objective is met.

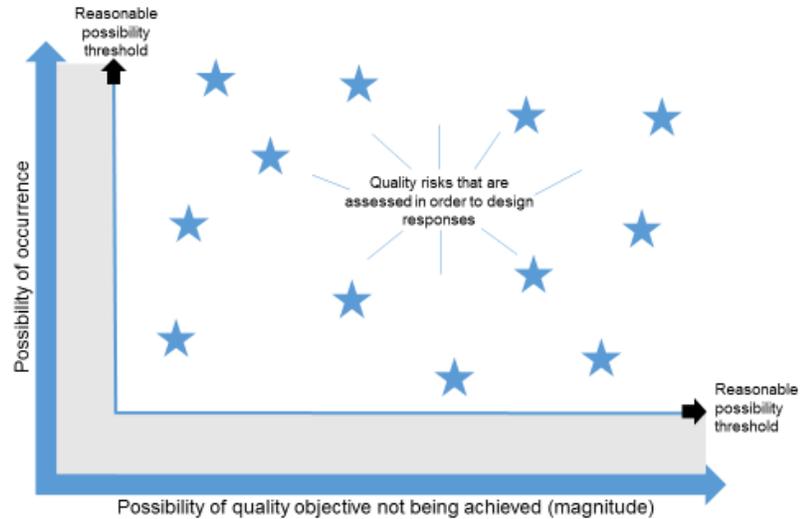
The Quality Risk Assessment Process

11. Since the last CAG discussion, the QCTF has comprehensively amended the quality risk assessment component. This component now only includes the process for (i) establishing quality objectives, (ii) identifying and assessing quality risks and (iii) designing and implementing responses to address the quality risks. The prescribed quality objectives that were previously in the QMP have instead been included in the individual components to which they relate.
12. The quality risk assessment process also includes a new, explicit requirement, for the firm to respond to changes in the nature and circumstances of the firm, the engagements performed by the firm and the types of entities for whom the engagements are undertaken, by determining whether the quality objectives, quality risks and responses remain appropriate and if not, modifying them as necessary. This promotes the maintenance of a system of quality management that is responsive to the firm's circumstances.
13. A focus of the QCTF discussions has been on establishing an appropriate threshold above which the quality risks are identified and assessed. The QCTF recognizes that it is impracticable for firms to identify and assess every possible risk that could arise, and it is therefore necessary to establish a threshold below which risks do not need to be identified or assessed. In the deliberations, the QCTF

considered the progress on the ISA 315 (Revised) project in relation to the identification and assessment of risks of material misstatement in an audit of financial statements, including the IAASB's concurrence to use the threshold of a "reasonable possibility that a misstatement may be material" regarding the threshold for determining relevant assertions.

14. The QCTF has therefore proposed that the firm:

- (a) Identifies quality risks, which are defined as risks that have a reasonable possibility of (i) occurring and (ii) a quality objective(s) not to be achieved.
- (b) In relation to those quality risks identified, assess the likelihood of the quality risks occurring and the relative effect of the quality risks on the achievement of the quality objectives. This assessment provides the basis for how the firm responds to the risk.



The QCTF is of the view that the above two steps, i.e., the identification and assessment of quality risks, in the context of a system of quality management, is a simultaneous exercise because the firm is already familiar with the conditions, events, circumstances, actions or inactions that give rise to the quality risks.

Matters for IAASB CAG Consideration

- 4. Representatives are asked to share their views regarding the proposed approach for the identification and assessment of quality risks.

The Overall Structure of the Components

15. In the proposals presented to the CAG in September 2017, the QCTF had included prescribed quality objectives and quality risks. As highlighted above, the prescribed quality objectives have been relocated to the individual components to which they relate. However, the QCTF noted that there was extensive duplication between the prescribed quality objectives and quality risks, and therefore proposed ISQC 1 (Revised) only includes prescribed quality objectives. It also includes required responses, however the standard is clear that these responses may be insufficient to address all possible quality risks that may arise and the firm designs and implements responses additional to those set out in the standard, as necessary to address their specific risks. The QCTF is of the view that this approach will facilitate improved behaviors, since firms will need to identify quality risks, given that none are provided in the standard.

Governance and Leadership

16. As highlighted in paragraph 7 above, since the previous discussions with the CAG, the governance and leadership component has changed in order to incorporate the quality risk assessment process. Therefore, this component now has prescribed quality objectives and responses.
17. The IAASB continues to encourage the QCTF to improve the emphasis on the firm's public interest role in proposed ISQC 1 (Revised). In the working draft previously discussed by the CAG, this was addressed through the governance principles that required the firm to take into consideration the legitimate and reasonable needs, interests and expectations of relevant stakeholders in formulating decisions in relation to quality. Since then, the QCTF has further enhanced the emphasis on the firm's public interest role through:
 - (a) Highlighting in the introduction of the standard the firm's responsibility to act in the public interest and explaining what this means. This is similar to how the International Ethics Standards Board for Accountants (IESBA) Code⁵ addresses the topic of public interest. The QCTF has further explained in this section that the interests of relevant stakeholders may change over time and may change the manner in which the firm's engagements are performed.
 - (b) Linking the considerations of the interests of relevant stakeholders to the firm's strategic decisions and actions, i.e., that the strategic decisions and actions take into consideration the firm's commitment to quality and financial and operational priorities do not override the firm's commitment to quality.
18. The governance and leadership section has also been enhanced to:
 - (a) Improve consistency with the requirements in proposed ISA 315 (Revised) in relation to the entity's control environment.
 - (b) Bring better emphasis to the consideration of financial and operational priorities in the context of the firm's commitment to quality.
 - (c) Improve and clarify the responsibilities of firm leadership, including their responsibility for assigning responsibility for (i) the system of quality management, (ii) compliance with independence requirements, and (iii) the monitoring and remediation process. This has been done in a manner to ensure appropriate flexibility, including recognizing that in some circumstances all of these functions may be fulfilled by the same person.
 - (d) Explain that firms may structure and organize themselves in a variety of ways, for example, the firm may concentrate or centralize processes or activities in a particular operating unit or location. This is included in the application material and is intended to emphasize that various forms of audit delivery models are part of the firm. Audit delivery models that are operated by the network are covered by the network services requirements.

⁵ The International Code of Ethics for Professional Accountants (including *International Independence Standards*), approved by the IESBA at its December 2017 meeting

Matters for IAASB CAG Consideration

5. Do Representatives have comments on the governance and leadership component described above?

Information and Communication

19. Since the September 2017 CAG discussion, the QCTF has made extensive improvements to the information and communication component. In addition to incorporating the quality risk assessment process into this component, the QCTF has:
 - (a) Improved the focus on two-way communication within the firm and emphasized the responsibility of all firm personnel for communication, including in relation to engagement teams' communication of information up to the firm. This also provides a link with proposed ISA 220 (Revised) whereby the engagement team is required to provide the firm with relevant information.
 - (b) Emphasized the need for the firm to communicate responsibilities to firm personnel and relevant and reliable information, such that they are able to carry out their responsibilities.
 - (c) Included a requirement for the firm to communicate, at least annually, relevant information in relation to the firm's system of quality management, including changes in the firm's system of quality management and the results of the annual "stand back" of the system of quality management (see paragraph 10).

Communication with External Parties, Including Transparency Reporting

20. In previous discussions with the CAG, CAG Representatives have emphasized the importance of transparency reporting. In considering the way forward, the QCTF noted that respondents to the Invitation to Comment (ITC), *Enhancing Audit Quality: A Focus on Professional Skepticism, Quality Control and Group Audits* were generally supportive of the proposed actions in the ITC. These actions included seeking to understand the demand and requirements for transparency reporting around the world, and how investors, regulators and others are using these reports, issuing guidance for firms, developing a thought piece or other non-authoritative material, or facilitating dialogue or encouraging research on the topic. While investors and certain other respondents called for the IAASB to more specifically address transparency reports in the IAASB's standards, respondents generally indicated that whatever actions the IAASB takes should not stifle innovation and the development of transparency reporting at a jurisdictional level. **Agenda Item 7 of the IAASB's March 2018 meeting** includes a more detailed analysis of the respondents' views.
21. The QCTF undertook research to establish what requirements or principles exist in various jurisdictions in relation to firms' transparency reports. Transparency reports are required in many jurisdictions, including the European Union (EU) (including the United Kingdom),⁶ Australia⁷ and Japan, and are typically required for firms that perform audits of public interest entities (PIEs) or certain listed entities. While not mandatory, transparency reports are also being produced by audit

⁶ EU Regulation 537/2014, which applies to financial years commencing on or after June 17, 2016

⁷ Sections 332–332G of the Corporations Act 2001

firms in the United States (US),⁸ Canada and other regions, although in some instances these are published in order to comply with the requirements of the EU where the firm has a registration in an EU country. The QCTF also considered the November 2015 International Organization of Securities Commissions (IOSCO) report on *Transparency of Firms that Audit Public Companies* (IOSCO report), which considers practices employed by audit firms and provides a guide for transparency reporting, and compared these recommendations to the matters that are required to be communicated in transparency reports issued in the EU and Australia.

22. Various aspects of proposed ISQC 1 (Revised) address how the firm considers and interacts with its relevant stakeholders, for example, the consideration of the legitimate interests of relevant stakeholders is one of the quality objectives in governance and leadership, and the monitoring and remediation component includes a requirement for the firm to consider whether it is appropriate to communicate information in relation to monitoring and remediation to external parties, as part of the overall communication with external parties.
23. The QCTF noted that firms may communicate information about its system of quality management with external parties in a variety of ways and how firms communicate with external parties continues to evolve, i.e., the information may not need to be communicated in a formal transparency report (unless required by law or regulation). The QCTF is of the view that requirements that specifically address transparency reports may inadvertently discourage the exchange of valuable and informative communication with external parties because of its perceived formality and may inadvertently scope out other forms of communication about the system of quality management that serve a similar purpose as a transparency report.
24. Furthermore, the QCTF considered whether the requirements should address the attributes of the information communicated with external parties. The QCTF noted that there may be circumstances when certain attributes may not be applicable to communication about the firm's system of quality management, for example, an attribute addressing relevance to the circumstances of the firm may not apply in circumstances when the communication contains standard information (i.e., it is boilerplate). The QCTF considered how ISA 701⁹ addresses the attributes of the communication of key audit matters, for example, how it addresses attributes such as succinctness and relevance. In this regard, the QCTF observed that these attributes are addressed in the application material in ISA 701.
25. Accordingly, the QCTF proposals in ISQC 1 (Revised) address communication with external parties more generally. These proposals include:
 - (a) A requirement to communicate information about the firm's system of quality management to parties external to the firm, as appropriate, taking into consideration factors that include the interests of stakeholders, the nature of the engagements the firm performs and the types of entities for whom such engagements are performed, and the requirements of law or regulation. The QCTF is of the view that this approach promotes the preparation of transparency reports in circumstances when providing such information is relevant and useful to the firm's stakeholders.

⁸ In the US these are referred to as Audit Quality Reports.

⁹ ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

- (b) Application material addressing the attributes of the communication to external parties, for example, that the communication:
 - (i) Addresses the circumstances of the firm and is prepared and presented in a timely manner.
 - (ii) Is presented in a clear and understandable manner that is neither misleading nor would inappropriately influence the users of the communication; and
 - (iii) Is accurate and complete in all material respects and does not contain information that is misleading.
 - (c) Application material explaining the type of content that may be included in communications with external parties. This application material notes that communication about changes affecting the firm and how the system of quality management has responded to such change is particularly useful.
26. The attributes described in paragraph 25(b) were developed taking into consideration:
- (i) The principles regarding the preparation and presentation of information in Section 220 of the IESBA Code.¹⁰
 - (ii) The recommended principles relating to the presentation of information in the IOSCO report.
 - (iii) Other sources where principles are established related to the communication of information relevant to the governance and operation of businesses, in particular, the International Integrated Reporting Council's (IIRC) *International Integrated Reporting Framework* (IR Framework) which sets out guiding principles and content elements for the preparation of integrated reports.¹¹

¹⁰ Paragraph R220.4 of the IESBA Code states that when preparing or presenting information, a professional accountant shall:

- (a) Prepare or present the information in accordance with a relevant reporting framework, where applicable;
- (b) Prepare or present the information in a manner that is intended neither to mislead nor to influence contractual or regulatory outcomes inappropriately;
- (c) Exercise professional judgment to:
 - (i) Represent the facts accurately and completely in all material respects;
 - (ii) Describe clearly the true nature of business transactions or activities; and
 - (iii) Classify and record information in a timely and proper manner; and
- (d) Not omit anything with the intention of rendering the information misleading or of influencing contractual or regulatory outcomes inappropriately.

¹¹ The content elements set out specific information that should be included in the integrated report, however the guiding principles were useful in developing principles that are relevant to the preparation of firms' transparency reports. The IIRC guiding principles include (i) strategic focus and future orientation; (ii) connectivity of information; (iii) stakeholder relationships; (iv) materiality; (v) conciseness; (vi) reliability and completeness; and (vii) consistency and comparability.

Matters for IAASB CAG Consideration

6. Representatives are asked to share their views regarding the proposals addressing communication with external parties.

Relevant Ethical Requirements, Engagement Acceptance and Continuance, Resources and Engagement Performance

27. Since the previous discussions with the CAG in September 2017, the QCTF has refined and reorganized these components according to the revised structure discussed previously in this paper. The QCTF has also:

- (a) Updated the requirements relating to relevant ethical requirements to align with the newly Restructured IESBA Code, approved by the IESBA in December 2017. The QCTF has also added a requirement in the governance and leadership component for firm leadership to assign operational responsibility for independence to an individual.
- (b) In relation to obtaining, using and allocating resources, included requirements for the firm to anticipate its future resourcing needs as well as how changes in the nature and circumstances of the firm, the engagements performed by the firm and the types of entities for whom the engagements are undertaken, affect the resources.
- (c) Introduced new requirements addressing intellectual resources and technological resources, that address considerations that include:
 - (i) Whether they are fit for purpose.
 - (ii) Establishing and maintaining an infrastructure or other resources to support the firm's technological resources.
 - (iii) The necessary security to prevent inappropriate access to the firm's technology.
 - (iv) The engagement team's responsibilities and supplementary actions that are required to be implemented at the engagement level in order to use the technology or intellectual resources.

The application material further explains considerations for the firm in obtaining and developing technological and intellectual resources, including when these are acquired externally.

- (d) More explicitly addressed how the firm supports professional judgment in the performance of engagements. This has been included through introducing a quality objective that states "judgments made by engagement teams in performing engagements and the conclusions reached are appropriate and undertaken in accordance with professional standards and applicable legal and regulatory requirements". Paragraphs 39–40 explain the QCTF's considerations in relation to professional skepticism.

Human Resources, Engagement Partner Competency and Engagement Partner Performance and Rewards

28. The QCTF has included various enhancements to the provisions addressing human resources. These include enhanced and new requirements in response to comments from respondents to the ITC in relation to the proposals in the ITC addressing:

- (a) The knowledge, skills and competence of firm personnel, appropriate continuity planning and the manner in which firm personnel are assigned to engagements.
- (b) The skills and competency of the engagement partner and the engagement partner's responsibilities for leading by example, coaching and mentoring.
- (c) The performance appraisals and remuneration of engagement partners, including how these are linked to engagement quality.

Agenda Item 7 of the IAASB's March 2018 meeting includes a more detailed analysis of the respondents' views.

29. The proposed requirements in ISQC 1 (Revised) have been enhanced from extant ISQC 1 to clarify the technical competence, professional skills and professional values, ethics and attitudes needed to perform engagements and other roles in the firm. Furthermore, the application material includes linkages with the International Education Standards (IES) issued by the International Accounting Education Standards Board (IAESB), including IES 7¹² and IES 8 (Revised),¹³ in order to further highlight what knowledge, skills and competencies may be appropriate. The requirements also address the responsibility of the firm to develop its personnel. Appropriate continuity planning is addressed through the overarching quality objective that places a focus on the anticipation of the firm's resourcing needs, and responding to changes in the firm's circumstances, engagements or the entities for whom the engagements are performed. The QCTF has also included a response for the firm to assign engagement personnel to engagements according to the nature and circumstances of the engagement, i.e., to recognize that some engagements within the firm carry more risk than others and firm personnel should be assigned accordingly.
30. The QCTF debated the extent to which the standard should address performance appraisals and remuneration of all firm personnel in the context of quality, considering the views of respondents to the ITC. The QCTF agreed that firms may incentivize personnel in a variety of ways, other than through remuneration, including through promotion, reward or other incentives. The QCTF also recognize the need for any requirements addressing performance appraisals and incentives to be scalable to facilitate application by small and medium sized practices (SMPs). The QCTF has therefore proposed two responses that require the firm to:
- (a) Evaluate, in a timely manner, firm personnel's commitment to quality and their maintenance and development of the technical competence, professional skills and professional values, ethics and attitudes to perform their roles. This need not be formal performance evaluations, which is explained in the supporting application material.
 - (b) Establish policies or procedures, appropriate to the nature and circumstances of the firm, that address compensation, promotion and other incentives with regard to firm personnel that demonstrate the firm's commitment to quality. This has been developed in a manner that emphasizes the importance of the incentives being appropriate for the firm, for example, in the case of a small firm, monetary incentives may not be practical in relation to engagement partners, however the engagement partners may be driven by their reputation within the firm. In some cases it may not be possible for the firm to establish these incentives, for example, in the case of a sole practitioner (it is noted that the standard allows for deviations from the

¹² IES 7, Continuing Professional Development (2014)

¹³ IES 8, Professional Competence for Engagement Partners Responsible for Audits of Financial Statements (Revised)

requirements when, in the circumstances of the firm, the requirement is not relevant to the firm).

Matters for IAASB CAG Consideration

7. Representatives are asked to share their views regarding the proposals addressing technological and intellectual resources described in paragraph 27(c), and whether these proposals adequately address matters that should be considered by firms in relation to these types of resources.
8. Representatives are asked to share their views regarding the proposals addressing performance appraisals and incentives of firm personnel, in particular whether these address the importance of firm personnel demonstrating a commitment to quality and are sufficiently flexible to be applied by all firms.

Monitoring and Remediation

31. Since the September 2017 CAG discussion, the QCTF has extensively debated and considered the requirements addressing monitoring and remediation. This has resulted in:

- (a) Refinements to the requirements addressing monitoring activities that focus on monitoring the system of quality management as a whole, rather than only focusing on the inspection of completed engagements. The QCTF has proposed various enhancements to emphasize a risk-based approach in designing the monitoring activities, including the inspection of completed engagements.

- (b) A new definition of deficiencies as follows:

“A deficiency in the system of quality management exists when:

- *The design of a response is not effective in addressing a related quality risk or the response necessary to address a quality risk is absent. Such a deficiency also is a deficiency in the firm’s quality risk assessment process.*
- *A response is not implemented appropriately.*
- *A response does not operate as designed.”*

The above definition focuses on the failure in the design, implementation or operation of a response because:

- (i) The QCTF is of the view that a failure by the firm to establish a quality objective or identify a risk would ultimately be picked up through the responses, for example, if the firm failed to identify a quality risk, a response would be missing or would be inadequate.
 - (ii) When performing monitoring activities, these are performed over the firms responses (it is not practicable to monitor quality risks).
- (c) A new framework for the identification and assessment of deficiencies in the system of quality management, in a manner that can be consistently applied by firms.
 - (d) Clarification of the firm’s responsibility to identify deficiencies in relation to the monitoring and remediation process itself. From a practical perspective, the QCTF is aware that it is not appropriate to establish requirements for the firm to design monitoring activities specifically addressing the monitoring and remediation process (i.e., monitoring of the monitoring).

Nevertheless, various sources of information may indicate a deficiency in the monitoring and remediation process, including the results of external inspections, or in performing the root cause analysis on deficiencies identified (i.e., they may reveal that the monitoring activities were inappropriate). This is now an explicit requirement for the firm to consider such information in identifying possible deficiencies in the monitoring and remediation process

- (e) Further enhancements and clarification of how the firm responds to deficiencies, i.e., performing the root cause analysis, evaluating the severity and pervasiveness of the deficiencies and communicating matters within the firm and externally.
32. The QCTF has also more clearly differentiated between the need for ongoing communication of matters related to monitoring and remediation versus annual communications about the system of quality management as a whole. Ongoing communication about the results of the firm's monitoring and remediation is necessary so that firm personnel can appropriately respond to the information in a timely manner. Annual communications form part of the information and communication component discussed in paragraph 19.
33. The flowchart in Appendix 2 illustrates the requirements of the monitoring and remediation process in proposed ISQC 1 (Revised).

Matters for IAASB CAG Consideration

- 9. Representatives are asked to share their views regarding the proposed monitoring and remediation process, including:
 - (a) Whether Representatives agree with the proposed definition of a deficiency.

Networks and Service Providers

34. The QCTF notes previous discussions with the CAG, which highlighted the intention of the QCTF to introduce requirements for firms in relation to the use of network-level services or activities, rather than requirements for networks themselves. As was noted in previous discussions, it is not practicable to impose requirements on the network itself, given the varying nature and scope of networks and their services and the remit of the IAASB's standards.
35. Since these discussions, the QCTF has developed new requirements for the firm in circumstances when the firm uses the services of a network. This includes a definition of "network services", which includes, for example, policies or procedures cascaded down by the network, quality objectives, quality risks and responses that are designed by the network and required to be implemented by all firms within the network, as well as any other activities provided by the network which the firm may not be obliged to use (e.g., training).
36. The new requirements, which were developed taking into consideration standards such as ISA 402¹⁴ and ISA 620,¹⁵ require the firm to:
- (a) Understand the network services available to the firm and the expected form, timing and content of communications between the firm and the network in relation to the network services. The QCTF is of the view that this requirement will encourage two-way communication

¹⁴ ISA 402, *Audit Considerations Relating to an Entity Using a Service Organization*

¹⁵ ISA 620, *Using the Work of an Auditor's Expert*

- between the firm and the network and encourages the firm to establish expectations for the network regarding what information is needed to support the system of quality management.
- (b) Identify the network services that the firm is required to use or intends to use in its system of quality management.
 - (c) Obtain an understanding of the network's processes related to the design, implementation, operation, as applicable, of the services, in order to evaluate and conclude whether, and the extent to which, the service is appropriate for use in the firm's system of quality management.
 - (d) Determine the firm's responsibilities and supplementary actions that need to be implemented by the firm in order to use the services provided by the network.
 - (e) Obtain the results of monitoring activities undertaken by the network and include the results in the firm's evaluation of information considered as part of its monitoring and remediation process.
 - (f) Communicate deficiencies identified in relation to the network's services to the network.
 - (g) Appropriately respond when deficiencies are identified in relation to the network services used by the firm, e.g., understand the remedial actions etc.
37. Application material has also been included to discuss sharing of information across the network about other network firms' systems of quality management, particularly when such information supports the firm's reliance on component auditors in the case of engagements performed in accordance with ISA 600.¹⁶

Service Providers

38. The QCTF noted that firms may use other types of service providers, for example, service providers who provide audit software or a methodology. Various outreach participants highlighted the need to address such circumstances, since if requirements were only developed for networks, it would be more onerous to be part of a network than to obtain services from another third party. Accordingly, the QCTF has introduced new requirements addressing the use of services from a service provider that are based on the requirements that have been established for network services set out above.

Matters for IAASB CAG Consideration

- 10. Representatives are asked to share their views regarding the proposed requirements set out in paragraph 36 above in relation to the firm's use of services provided by the network.
- 11. Do Representatives support requirements that address service providers?

Professional Judgment and Professional Skepticism

39. In the fourth quarter of 2017, the Chair of the QCTF, Chair of the Professional Skepticism Working Group and various members of IAASB Staff met to further discuss how proposed ISQC 1 (Revised) could address creating an environment that supports and fosters the application of professional skepticism. Matters discussed included:

¹⁶ ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*
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- (a) Using the term “professional skepticism” within the standard, which is unlikely to drive a change in behavior or mindset.
 - (b) The importance of a culture of ethical values in creating an environment to support the application of professional skepticism. It was noted that adequate time to perform the engagement and sufficient fees may also influence the application of professional skepticism on the engagement.
 - (c) The role of the engagement quality control reviewer in evaluating whether the engagement team has appropriately applied professional skepticism in relation to professional judgments, as well as the professional skepticism that should be applied by the engagement quality control reviewer in undertaking the review.
40. In addition to these discussions, the QCTF undertook an analysis of the impediments to professional skepticism identified through the responses to the ITC,¹⁷ and how such impediments may be addressed at the firm level. The QCTF is of the view that proposed ISQC 1 (Revised) establishes various requirements for the firm that create an environment that supports and promotes the application of professional skepticism, including through:
- (a) The culture of the firm, including the responsibility of firm leadership for establishing and embedding the culture throughout the firm.
 - (b) Emphasizing that commercial considerations should not override quality, and the importance of obtaining appropriate financial resources to support the performance of engagements.
 - (c) Establishing and assigning appropriate resources, in particular human resources who have sufficient capacity, appropriate technical competence, professional skills and professional values, ethics and attitudes to perform engagements.
 - (d) Evaluating firm personnel and addressing compensation, promotion and other incentives.
 - (e) Clearly establishing and communicating responsibilities in relation to direction supervision and review.
 - (f) Establishing appropriate processes to address consultation and differences of opinion.

Matters for IAASB CAG Consideration

12. Representatives are asked to share their views regarding whether proposed ISQC 1 (Revised) adequately addresses matters that create an environment that supports and fosters the application of professional skepticism at the engagement level.

¹⁷ See Agenda Item 8–B of the September 2016 IAASB meeting, [Responses to Invitation to Comment—Excerpt of Impediments to Professional Skepticism and Relationship to Fundamental Principles in IESBA Code of Ethics](#)

Appendix 1

Comparison of Components

Components in Proposed ISQC 1 (Revised)	Elements in Proposed ISA 220 (Revised)¹⁸	Components in the COSO Integrated Framework
Governance and leadership	Leadership Responsibilities for Managing and Achieving Quality on Audits	Control environment
The quality risk assessment process		Risk Assessment
Information and communication		Information and communication
Relevant ethical requirements	Relevant ethical requirements	Control activities
Acceptance and continuance of client relationships and specific engagements	Acceptance and continuance of client relationships and specific engagements	
Resources	Engagement resources	
Engagement performance	Engagement performance	
The monitoring and remediation process	Monitoring and remediation	Monitoring

¹⁸ As proposed by the ISA 220 Task Force to the IAASB in December 2017.

Appendix 2

Process Flow of the Monitoring and Remediation Process

