

DRAFT EXPOSURE DRAFT OF INTERNATIONAL STANDARD ON QUALITY CONTROL 1 (REVISED) – QUALITY MANAGEMENT FOR FIRMS THAT PERFORM AUDITS OR REVIEWS OF FINANCIAL STATEMENTS, OR OTHER ASSURANCE OR RELATED SERVICES ENGAGEMENTS

SECOND READ (CLEAN VERSION)

(Effective as of TBD)

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Introduction

Scope of this ISQC

1. This International Standard on Quality Control (ISQC) deals with a firm's responsibilities to design, implement and operate a system of quality management for audits or reviews of financial statements, or other assurance or related services engagements.
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 (Revised),¹ for example, deals with the management of quality for audits of financial statements and establishes requirements for the engagement team. [*Placeholder to add additional explanation when proposed ISA 220 (Revised) is finalized.*] Law, regulation or relevant ethical requirements may also establish responsibilities for the firm in relation to the management of quality beyond those described in this ISQC. (Ref: Para. A1)

The Firm's System of Quality Management

3. When undertaking engagements, the firm and its personnel accepts their responsibility to act in the public interest. Acting in the public interest involves applying professional values, ethics and attitudes in making decisions that promote a commitment to quality, and take into consideration the legitimate interests of relevant stakeholders, in particular users of the firm's reports. The legitimate interests of relevant stakeholders may change over time and may change the manner in which the firm's engagements are performed.
4. The firm further promotes the public interest through establishing an environment, including a culture, decision-making process, actions, organization, leadership and resources that supports the performance of engagements in accordance with professional standards and applicable legal and regulatory requirements and judgments and conclusions that are appropriate.
5. A firm's system of quality management is designed to provide the firm with reasonable assurance that the firm achieves its objectives set out in paragraphs 15(a) and (b). The system of quality management comprises the following eight components that operate in an integrated manner, which are further explained in paragraph 19: (Ref: Para. A2–A3)
 - (a) The quality management process;

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

- (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.
6. Professional judgment in designing, implementing and operating the system of quality management is necessary for the establishment of a system of quality management that is designed to the nature and circumstances of the firm, the engagements it performs and the types of entities for whom such engagements are undertaken. Professional judgment involves applying relevant knowledge and experience to the facts and circumstances. (Ref: Para. A4)
7. Designing, implementing, and operating a system of quality management includes maintaining and updating the system to address:
- 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; or
 - The results of the firm's monitoring activities, external inspections or other relevant information.

Authority of the ISQCs

8. 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 updated in accordance with ISQC 2: 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.*]
9. 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 12, and introductory material that provides context relevant to a proper understanding of the ISQCs, and definitions.
10. 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.
11. The requirements of the ISQCs are expressed using “shall.”
12. 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, or firms that operate as part of a network are included within the application and other explanatory material. 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 engagement quality control reviewer*] to apply and comply with the requirements in the ISQCs.

13. 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.²

Effective Date

14. Systems of quality management in compliance with this ISQC are required to be established by TBD.

Objective

15. 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.

Definitions

16. 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 (referred to as deficiency in this ISQC) – This exists when:
 - (i) 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;
 - (ii) A response is not implemented appropriately; or
 - (iii) A response does not operate as designed.

² The Glossary of Terms may also include descriptions of other terms found in the ISQCs to assist in common and consistent interpretation and translation, however which have not been subject to the IAASB’s stated due process.

- (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 partner³ – The partner or other individual 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).⁴
- (h) External inspections – Inspections or investigations or other reviews, 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, or where relevant, public sector equivalent. (Ref: Para. A5)
- (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.
- (k) Monitoring – A process comprising ongoing and periodic evaluations of the design, implementation and operation of the system of quality management.
- (l) Network firm – A firm or entity that belongs to a network.
- (m) Network⁵ – A larger structure: (Ref: Para. A6–A7)
 - (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.
- (n) Network services – In relation to the firm’s system of quality management: (Ref: Para: A8–A10)

³ “Engagement partner,” “partner,” and “firm” should be read as referring to their public sector equivalents where relevant.

⁴ 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.

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

- (i) Information or assistance provided by, or available from, the network; or
 - (ii) Requirements established by the network for quality objectives, quality risks or responses.
- (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) Quality objectives (in relation to a system of quality management) – The objectives established by the firm that are what the firm needs to achieve to support the design, implementation and operation of the system of quality management.
- (s) Quality risk (in relation to a system of quality management) – A risk that has a reasonable possibility of occurring and a reasonable possibility of causing the quality objective(s) not to be achieved, before consideration of any related responses.
- (t) Reasonable assurance – In the context of this ISQC, a high, but not absolute, level of assurance.
- (u) Relevant ethical requirements (in relation to the ISQCs) – [*To be further considered: Extant definition:* Ethical requirements to which the engagement team and engagement quality control reviewer are subject, which ordinarily comprise Parts A and B of the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with national requirements that are more restrictive.]
- (v) Remediation – A process to identify and implement corrective actions to address deficiencies identified in the firm's system of quality management.
- (w) Response (in relation to a system of quality management) – Policies or procedures implemented by the firm to address a quality risk: (Ref: Para. A11–A13)
- (i) Policies are statements of what should, or should not, be done to achieve the quality objectives. Such statements may be documented, explicitly stated in communications or implied through actions and decisions.
 - (ii) Procedures are actions to implement policies.
- (x) Root cause analysis – A process for investigating the underlying cause(s) of findings from the firm's monitoring activities, external inspections or any other relevant information.
- (y) Staff – Professionals, other than partners, including any experts the firm employs.
- (z) System of quality management – A system designed, implemented and operated by a firm in accordance with ISQC 1 that consists of the following eight integrated components:
- (i) Governance and leadership;
 - (ii) The quality risk assessment process;
 - (iii) Information and communication;

- (iv) Relevant ethical requirements;
- (v) Acceptance and continuance of client relationships and specific engagements;
- (vi) Resources;
- (vii) Engagement performance; and
- (viii) The monitoring and remediation process.

Requirements

Applying, and Complying with, Relevant Requirements

17. The individual(s) assigned ultimate responsibility and accountability and the individual(s) assigned operational responsibility for the firm's system of quality management shall have an understanding of this ISQC relevant to their responsibilities, including application and other explanatory material, to understand the objective of this ISQC and to apply its requirements properly. (Ref: Para. A14)
18. 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. A15)

System of Quality Management

19. The firm shall design, implement and operate a system of quality management, in accordance with paragraphs 20 to 65, which set forth the requirements regarding each of the eight inter-related components, such that the firm: (Ref: Para. A16–A17)
 - (a) Establishes an environment, including a culture, decision-making process, actions, organization and leadership, that supports the design and operation of the other components of the system of quality management (governance and leadership);
 - (b) Identifies risks to the achievement of quality objectives for each component of the system of quality management and assesses the risks as a basis for determining the responses to those risks (quality risk assessment process);
 - (c) Obtains, generates or uses relevant information and communicates relevant information internally and externally on a timely basis to support the design, implementation and operation of the system of quality management (information and communication);
 - (d) Manages compliance with relevant ethical requirements, in order that the firm, its personnel and others subject to relevant ethical requirements, as applicable (including network firm personnel), fulfill their respective responsibilities in respect of relevant ethical requirements (relevant ethical requirements);
 - (e) Applies appropriate judgment when accepting or continuing client relationships and specific engagements (acceptance and continuance of client relationships and specific engagements);
 - (f) Appropriately obtains, develops, uses, maintains and allocates financial resources, human resources, technological resources, and intellectual resources to support the design, implementation and operation of the system of quality management in a timely manner;
 - (g) Appropriately performs and documents engagements in accordance with professional standards and legal and regulatory requirements, including making judgments and reaching conclusions that are appropriate; and

- (h) Evaluates the design, implementation and operation of the system of quality management.

Governance and Leadership

Quality Objectives

20. The firm shall establish quality objectives, in accordance with paragraph 25(a), that address the aspects of the firm's environment that support the design and operation of the other components of the system of quality management, including the firm's culture, decision-making process, actions, organization and leadership. In doing so, the firm shall include the following quality objectives: (Ref: Para A18)
- (a) The firm's 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 or performing duties in relation to the system of quality management. (Ref: Para A20–A21)
 - (b) The firm has leadership who are responsible and accountable for quality.
 - (c) The firm's strategic decisions and actions reflect the firm's commitment to quality and take into consideration the legitimate interests of relevant stakeholders, including that financial and operational priorities do not override the firm's commitment to quality. (Ref: Para A22–A24)
 - (d) The firm is organized, and resources obtained and allocated, in a manner that supports the firm's strategic decisions and actions and the effective design, implementation and operation of the firm's system of quality management. (Ref: Para A25–A29)
 - (e) The firm complies with the requirements of law, regulation, or professional standards that relate to the governance and leadership of the firm, if applicable. (Ref: Para A19)

Quality Risks

21. The firm shall identify and assess the quality risks in relation to governance and leadership in accordance with paragraphs 25(b).

Responses to the Quality Risks

22. The firm shall design and implement responses in accordance with paragraph 25(c), to address the quality risks in relation to governance and leadership. The responses that are designed and implemented by the firm shall include the following:
- (a) Assigning ultimate responsibility and accountability for the system of quality management to the firm's chief executive officer or managing partner (or equivalent) or, if appropriate, the firm's managing board of partners (or equivalent). The individual(s) assuming such responsibility and accountability shall: (Ref: Para. A30)
 - (i) Demonstrate, through their actions, a commitment to quality, including professional values, ethics and attitudes and establish the expected values and behavior of all firm personnel for quality in conducting engagements and performing duties in relation to the system of quality management. (Ref: Para A20–A21)

- (ii) Exercise appropriate judgment about the legitimate interests of relevant stakeholders when making decisions in relation to the firm's strategic decisions and actions. (Ref: Para A22–A24)
 - (iii) Establish structures, reporting lines, and appropriate authorities and responsibilities, including assigning operational responsibility for the matters below to personnel that meet the eligibility criteria set out in paragraph 23. Such assignments shall include: (Ref: Para A31–A33)
 - a. Operational responsibility for the system of quality management as a whole; and
 - b. Operational responsibility for specific aspects of the system of quality management, as appropriate to the nature and circumstances of the firm, which shall include assigning operational responsibility for compliance with independence requirements and the monitoring and remediation process.
 - (iv) Obtain and allocate resources in a manner that supports the firm's strategic decisions and actions and the effective design, implementation and operation of the firm's system of quality management. (Ref: Para A25–A29)
- (b) Establishing policies or procedures for periodic performance evaluations of the individual(s) assigned ultimate responsibility and accountability and the individual(s) assigned operational responsibility for the matters set out in paragraph 22(a)(iii) to: (Ref: Para. A35–A37)
- (i) Evaluate whether they have fulfilled their responsibilities in relation to the system of quality management; and
 - (ii) Hold individuals accountable for the responsibilities assigned to them.
23. The individual(s) assigned operational responsibility for the matters set out in paragraph 22(a)(iii) shall have: (Ref: Para. A34)
- (a) The appropriate experience and knowledge and sufficient time to assume their assigned responsibility;
 - (b) A direct reporting line of communication to the individual(s) assigned ultimate responsibility and accountability for quality; and
 - (c) An understanding of their operational responsibilities for the firm's system of quality management.

Quality Risk Assessment Process

24. The firm shall apply the quality risk assessment process to 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.

25. In applying the quality risk assessment process, the firm shall: (Ref: Para. A38)
- (a) Establish quality objectives relevant to the nature and circumstances of the firm, the engagements performed by the firm and the types of entities for whom the engagements are undertaken, that are set at an appropriate level of granularity to enable the firm to identify and assess the quality risks. (Ref: Para. A39)
 - (b) As a basis for designing responses, identify and assess the quality risks through: (Ref: Para. A40–A42)
 - (i) Understanding the conditions, events, circumstances, actions or inactions that affect the achievement of the quality objectives in order to identify the quality risks; and
 - (ii) Assessing the likelihood of the quality risks occurring and the relative effect of the quality risks on the achievement of the quality objectives.
 - (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 be responsive to the reasons for the assessment given to the quality risks. (Ref: Para. A43–A47)
26. The firm shall 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. (Ref: Para. A48)

Information and Communication

Quality Objectives

27. The firm shall establish quality objectives, in accordance with paragraph 25(a), that address obtaining, generating or using relevant information and communicating relevant information internally and externally on a timely basis to support the design, implementation and operation of the system of quality management. In doing so, the firm shall include the following quality objectives: (Ref: Para. A49)
- (a) The firm obtains or generates relevant and reliable information from both internal and external sources to support the design, implementation and operation of the components of the system of quality management. (Ref: Para. A50)
 - (b) The firm creates an environment that promotes the exchange of appropriate information among the firm and its personnel and emphasizes the responsibility of all firm personnel for communication in conducting engagements and performing duties in relation to the system of quality management. (Ref: Para. A51)
 - (c) The firm communicates relevant and reliable information in a timely manner to firm personnel, such that they are able to understand and carry out their responsibilities in relation to the performance of engagements and duties in relation to the system of quality management. (Ref: Para. A51)
 - (d) The firm communicates information to external parties as required by law, regulation or relevant ethical requirements and obtains or communicates other information relevant to the system of

quality management, as appropriate, with parties that are external to the firm, unless prohibited by law or regulation. (Ref: Para. A51, A58–A64)

Quality Risks

28. The firm shall identify and assess the quality risks in relation to information and communication in accordance with paragraph 25(b).

Responses to the Quality Risks

29. The firm shall design and implement responses in accordance with paragraph 25(c) to address the quality risks in relation to information and communication. The responses that are designed and implemented by the firm shall include the following:
- (a) Establishing policies or procedures that address the identification, capture, process and maintenance of information to support the operation of the components of the system of quality management. (Ref: Para. A50)
 - (b) Communicating the engagement team’s responsibilities with respect to the implementation of responses and establishing policies or procedures addressing the exchange of information between the firm and engagement teams, in order to enable and support the proper functioning of the system of quality management. (Ref: Para. A44)
 - (c) Establishing policies or procedures that address the exchange of information between the firm and personnel performing duties in relation to the operation of the firm’s system of quality management, including the individual(s) assigned ultimate responsibility and accountability and the individual(s) assigned operational responsibility for the system of quality management.
 - (d) Communicating on a timely basis to firm personnel information in relation to the firm’s system of quality management that is relevant to their responsibilities, including changes in the firm’s system of quality management and the results of the evaluation of the system of quality management in paragraph 55. (Ref: Para. A52)
 - (e) Establishing clearly defined channels within the firm that enable reporting by firm personnel or external parties to appropriate individual(s) within the firm, of concerns in relation to the commitment to quality of the firm or its personnel, without fear of reprisal and establishing policies or procedures that enable the investigation of such concerns. (Ref: Para. A53–A57)
 - (f) Communicating information about the firm’s system of quality management to parties external to the firm, as appropriate, taking into consideration the following factors regarding the nature, timing and extent of such communications: (Ref: Para A58, A61–A64)
 - (i) The communication requirements set out in law, regulation or professional standards, where relevant;
 - (ii) The legitimate interests of the firm’s relevant stakeholders; and (Ref: Para A59)
 - (iii) The nature of the engagements the firm performs and the types of entities for whom such engagements are performed. (Ref: Para A60)

Relevant Ethical Requirements

Quality Objectives

32. The firm shall establish quality objectives, in accordance with paragraph 25(a), that address the fulfillment of responsibilities by the firm, its personnel and others subject to relevant ethical requirements, as applicable (including network firm personnel), in relation to the relevant ethical requirements. In doing so, the firm shall include the following quality objectives: (Ref: Para. A65–A66)
- (a) The firm, its personnel and others subject to relevant ethical requirements, as applicable (including network firm personnel), have an understanding of relevant ethical requirements, including the independence requirements.
 - (b) The firm, its personnel and others subject to relevant ethical requirements, as applicable (including network firm personnel), fulfill their responsibilities in relation to the relevant ethical requirements, including the independence requirements.
 - (c) The firm, its personnel and others subject to relevant ethical requirements, as applicable (including network firm personnel), identify and appropriately respond to breaches of the relevant ethical requirements, including the independence requirements, in a timely manner.

Quality Risks

33. The firm shall identify and assess the quality risks in relation to relevant ethical requirements in accordance with paragraph 25(b).

Responses to the Quality Risks

34. The firm shall design and implement responses in accordance with paragraph 25(c) to address the quality risks in relation to relevant ethical requirements. The responses that are designed and implemented by the firm shall include the following: (Ref: Para. A67, A71)
- (a) Establishing policies or procedures that enable the firm and its personnel to:
 - (i) Identify threats to compliance with the relevant ethical requirements, including the independence requirements;
 - (ii) Evaluate whether identified threats are at an acceptable level; and (Ref: Para. A68)
 - (iii) In circumstances when the identified threats are not at an acceptable level, address the threats appropriately. (Ref: Para. A69)
 - (b) Establishing policies or procedures that facilitate appropriate responses to breaches of the relevant ethical requirements, including the independence requirements, and which address:
 - (i) The evaluation of the significance of a breach and its effect on the fulfillment of the relevant ethical requirements;
 - (ii) Taking whatever actions might be available, as soon as possible, to address the consequences of a breach satisfactorily;
 - (iii) Determining whether to report a breach to relevant parties; and

- (iv) Fulfilling the responsibilities in relation to the provisions of the relevant ethical requirements, including the independence requirements, that set out actions to address identified breaches. (Ref: Para. A70)
- (c) Obtaining, at least annually, a documented 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

Quality Objectives

35. The firm shall establish quality objectives, in accordance with paragraph 25(a), that address applying appropriate judgment when making decisions in relation to the acceptance or continuance of client relationships and specific engagements. In doing so, the firm shall include the following quality objectives:
- (a) The firm obtains sufficient and appropriate information about the nature and circumstances of the engagement and the integrity and ethical values of the client, including management, and, when appropriate, those charged with governance, before accepting and continuing the client relationship or specific engagement. (Ref: Para. A71a–A76)
 - (b) The firm makes appropriate judgments about the integrity and ethical values of the client, including management, and, when appropriate, those charged with governance. (Ref: Para. A72–A76)
 - (c) The firm makes appropriate judgments about the firm’s ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements, including: (Ref: Para. A77–A78)
 - (i) The firm has appropriate resources to perform the engagement, including that financial and operational priorities do not override the firm’s commitment to quality;
 - (ii) The firm has access to information, or the persons from whom the firm determines it is necessary to obtain information, to be able to perform the engagement; and
 - (iii) The firm is able to fulfill relevant ethical requirements, including independence.
 - (d) The firm responds appropriately in circumstances when subsequent to client or engagement acceptance 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

36. The firm shall identify and assess the quality risks in relation to the acceptance and continuance of client relationships and specific engagements in accordance with paragraph 25(b).

Responses to the Quality Risks

37. The firm shall design and implement responses in accordance with paragraph 25(c) to address the quality risks in relation to acceptance and continuance of client relationships and specific engagements. The responses that are designed and implemented by the firm shall include establishing policies or procedures that address:
- (a) Obtaining and evaluating sufficient information to make appropriate judgments regarding the firm's decisions to accept, continue, or discontinue the client relationship or specific engagement. (Ref: Para. A72–A76)
 - (b) Obtaining confirmation from management of the entity, and, when appropriate, those charged with governance, that they acknowledge and understand their responsibilities in relation to the engagement before accepting and continuing the client relationship or specific engagement.
 - (c) Circumstances when the firm is obligated by law or regulation to accept the client relationship or specific engagement. (Ref: Para. A80)

Resources

Quality Objectives

38. The firm shall establish quality objectives, in accordance with paragraph 25(a), that address appropriately obtaining, developing, using, maintaining and allocating financial resources, human resources, technological resources, and intellectual resources in a timely manner to support the design, implementation and operation of the system of quality management. In doing so, the firm shall include the following quality objectives:
- (a) The firm obtains, develops uses, maintains and allocates resources to support the performance of engagements and the operation of the system of quality management, including: (Ref: Para. A81–A83)
 - (i) Adequate anticipation of resource needs; and
 - (ii) That resource needs are appropriately addressed as a result of 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.
 - (b) The firm attracts, develops or retains personnel, including engagement partners, who have: (Ref: Para. A84–A85)
 - (i) Appropriate technical competence, professional skills and professional values, ethics and attitudes to perform engagements, including knowledge or experience regarding professional standards, including relevant ethical requirements, and applicable law or regulation in relation to the engagements the firm performs;
 - (ii) Competence and experience to perform duties 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. (Ref: Para. A86–A87)

- (d) Firm personnel fulfill their responsibilities in relation to the system of quality management and demonstrate and are accountable for their commitment to quality. (Ref: Para. A88–A89)
- (e) The firm obtains or develops, implements and maintains, technological resources to appropriately support the operation of the firm’s system of quality management and the consistent performance of engagements. (Ref: Para. A90–A92)
- (f) The firm obtains or develops, and maintains, intellectual resources to support the consistent performance of engagements, and such intellectual resources are consistent with professional standards and applicable legal and regulatory requirements, where applicable. (Ref: Para. A93)
- (g) Firm personnel are able to appropriately apply or use the firm’s technological and intellectual resources. (Ref: Para. A92)

Quality Risks

39. The firm shall identify and assess the quality risks in relation to resources in accordance with paragraph 25(b).

Responses to the Quality Risks

40. The firm shall design and implement responses in accordance with paragraph 25(c) to address the quality risks in relation to resources. The responses that are designed and implemented by the firm shall include the following:
- (a) Establishing policies or procedures addressing the assignment of engagement partners and personnel to engagements according to the nature and circumstances of the engagement. (Ref: Para. A86–A87)
 - (b) Supporting the development of firm personnel through appropriate training that develops knowledge, skills, and abilities with respect to their roles and responsibilities and in response to changes in the nature and circumstances of the firm, the engagements it performs and the types of entities for whom such engagements are undertaken, including changes in relation to professional standards and technology. (Ref: Para. A84–A85)
 - (c) Evaluating, 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. (Ref: Para. A88)
 - (d) Establishing 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. (Ref: Para. A89)
 - (e) Establishing policies or procedures addressing how technology is obtained or developed, and maintained, or implemented, that include: (Ref: Para. A90–A92)
 - (i) Determining whether the technology obtained or developed is designed in a manner that is suitable for its intended purpose;
 - (ii) Establishing and maintaining an infrastructure or other resources appropriate to the firm’s circumstances to support the firm’s technological resources;
 - (iii) The necessary security to prevent inappropriate access to the firm’s technology; and

- (iv) The firm personnel's responsibilities and supplementary actions that are required in order to use the technology at the engagement level or in the system of quality management.
- (f) Establishing policies or procedures addressing how intellectual resources are obtained, developed or maintained, that include the firm personnel's responsibilities and supplementary actions that are required in order to use the intellectual resources at the engagement level or in the system of quality management. (Ref: Para. A93)

Engagement Performance

Quality Objectives

41. The firm shall establish quality objectives, in accordance with paragraph 25(a), that address the appropriate performance and documentation of the engagement in accordance with professional standards and legal and regulatory requirements, including making judgments and reaching conclusions that are appropriate. In doing so, the firm shall include the following quality objectives:
- (a) Firm personnel understand and fulfill their responsibilities in respect of the engagement, including, as applicable: (Ref: Para. A94–A95)
 - (i) The appropriate direction and supervision of the engagement team and review of the work of the engagement team; and
 - (ii) The review by more experienced engagement team members of work performed by less experienced team members.
 - (b) 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. (Ref: Para: A96–A97)
 - (c) *[Placeholder for alignment with proposed ISA 220 (Revised) regarding the responsibilities of the engagement partner]*
 - (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. A101–A106)

Quality Risks

42. The firm shall identify and assess the quality risks in relation to engagement performance in accordance with paragraph 25(b).

Responses to the Quality Risks

43. The firm shall design and implement responses in accordance with paragraph 25(c) to address the quality risks in relation to engagement performance. The responses that are designed and implemented by the firm shall include establishing policies or procedures addressing:
- (a) Consultation, including firm personnel's responsibilities in relation to consultations, the matters on which consultation is required and how the conclusions should be agreed and implemented. (Ref: Para. A98–A99)

- (b) Differences of opinion that arise within the engagement team, or between the engagement team and the engagement quality control reviewer or personnel performing duties in relation to the operation of the firm's system of quality management, including those who provide consultation. (Ref: Para. A100)
- (c) *[Placeholder for engagement quality control reviews]*

Monitoring and Remediation Process

44. The firm shall establish a monitoring and remediation process that evaluates the design, implementation and operation of the system of quality management, through: (Ref: Para. A107)
- (a) Designing and performing activities to monitor the design, implementation and operation of the responses;
 - (b) Evaluating the findings of the monitoring activities, the results of external inspections and other relevant information; and
 - (c) Taking appropriate actions based on the results of internal monitoring activities, external inspections and other relevant information.

Designing and Performing Activities to Monitor the Design, Implementation and Operation of the Responses

45. 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. A108–A110)
- (a) The assessment of the quality risks and the design of the responses to the quality risks, including the classes of engagements where quality risks are more likely to occur or may result in a greater likelihood that a quality objective would not be met; (Ref: Para. A111)
 - (b) Changes in factors that have affected the firm's system of quality management; (Ref: Para. A112)
 - (c) The 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 (Ref: Para. A113)
 - (d) Other relevant information that may suggest deficiencies exist in the firm's system of quality management, including concerns identified regarding the commitment to quality of the firm or its personnel and information from external inspections. (Ref: Para. A113–A113a)
46. As part of its monitoring activities, the firm shall establish policies or procedures requiring the inspection of completed engagements. Such policies or procedures shall establish criteria that take into consideration the factors set out in paragraph 45 and include the inspection of at least one completed engagement for each engagement partner on a cyclical basis determined by the firm. (Ref: Para. A114–A117)
47. The firm shall perform the monitoring activities as designed. In doing so, the firm shall:
- (a) Determine that those performing the monitoring activities have the competence, experience and knowledge and sufficient time to perform the monitoring activity and are objective in relation to the activity subject to monitoring; and

- (b) Determine whether the findings arising from the monitoring activities include deficiencies. (Ref: Para. A119–A121)
- 48. The firm shall determine whether the results of external inspections and any other relevant information include deficiencies. (Ref: Para. A118–A121)
- 49. The firm shall also evaluate the design, implementation and operation of the monitoring and remediation process, through considering the findings arising from the monitoring activities and the results of external inspections and any other relevant information and determining whether there are deficiencies in the monitoring and remediation process. (Ref: Para. A122)

Root Cause Analysis and Evaluating the Deficiencies

- 50. The firm shall investigate the root cause(s) of the deficiencies and in doing so shall: (Ref: Para. A123–A127)
 - (a) Consider the nature of the deficiencies and their possible severity in determining the nature, timing and extent of the procedures to investigate the root cause;
 - (b) Consider whether the deficiency is in the design, implementation or operation of a response; and
 - (c) Evaluate the effect of the deficiencies on the achievement of the quality objectives, through considering the severity and pervasiveness of the deficiencies.

Responding Appropriately to the Results of Internal Monitoring Activities, External Inspections and Other Relevant Information

- 51. 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. A128)
 - (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.
- 52. The firm shall design and implement remedial actions to address the deficiencies and their related root cause(s) that are responsive to the results of the root cause analysis. In doing so, the firm shall determine whether the quality objectives, quality risks or responses remain appropriate. (Ref: Para. A129–A130)
- 53. The individual(s) assigned ultimate responsibility for the system or quality management or the individual assigned operational responsibility for the system of quality management, shall evaluate whether the remedial actions are appropriately designed to address the deficiencies and their related root cause(s) and determine whether they have been implemented. (Ref: Para. A131)

Ongoing Communication Related to Monitoring and Remediation

- 54. The individual responsible for the monitoring and remediation process shall communicate on a timely basis to the individual(s) assigned ultimate responsibility and accountability and the individual(s) assigned operational responsibility for the system of quality management: (Ref: Para. A132)
 - (a) A description of the monitoring activities performed;

- (b) The deficiencies identified by the firm through the findings from the firm’s monitoring activities, the results of external inspections and other relevant information, including the severity and pervasiveness of such deficiencies; and
 - (c) The remedial actions to address the deficiencies, including the planned communication to firm personnel and parties that are external to the firm, as necessary.
55. The firm shall communicate on a timely basis to firm personnel information in relation to the firm’s monitoring and remediation process as described in paragraph 54 that is relevant to their responsibilities. The nature, timing and extent of the information communicated shall be sufficient to enable the firm personnel to take prompt and appropriate action in accordance with their responsibilities. (Ref: Para. A133–A135)
56. The firm shall communicate information in relation to the results of the firm’s monitoring and remediation process, on timely basis, in accordance with paragraph 29(f).

Evaluating the Effectiveness of the System of Quality Management

57. The individual(s) assigned ultimate responsibility and accountability for the system of quality management shall evaluate whether the system of quality management provides the firm with reasonable assurance in accordance with paragraph 15: (Ref: Para. A137)
- (a) On an annual basis; or
 - (b) In circumstances when the deficiencies identified are of a severity and pervasiveness that indicate that the system may not be providing the firm reasonable assurance.
58. In circumstances when the firm’s evaluation in paragraph 57 indicates that the firm has not achieved reasonable assurance in accordance with paragraph 15, the firm shall: (Ref: Para. A138)
- (a) Promptly communicate to firm personnel information relevant to their responsibilities about the deficiency(ies) and the remedial actions to be taken; and
 - (b) If appropriate, communicate relevant information about the firm’s evaluation to parties that are external to the firm.

Considerations Relating to Networks

59. In circumstances when the firm operates as part of a network, the firm shall: (Ref: Para. A139–A141)
- (a) Understand the network services available to the firm that may be relevant to the firm’s system of quality management and the expected form, timing and content of communications between the firm and the network in relation to the network services; and
 - (b) Identify the network services that the firm is required to use or intends to use in its system of quality management.
60. In relation to the identified network services to be used by the firm, 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 and conclude whether, and the extent to which, the service is appropriate for use in the firm’s system of quality management; and (Ref: Para. A142–A143)

- (b) 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. (Ref: Para. A144)

Monitoring and Remediation Process

- 61. If the network performs monitoring activities in relation to the firm's system of quality management, the firm shall obtain the results of such monitoring activities and include them in the evaluation of the results of the external inspections and any other relevant information, as required by paragraph 48. (Ref: Para. A145–A147)
- 62. If the monitoring activities performed by the firm identify deficiencies in the network's services, the firm shall communicate to the network relevant information about the identified deficiencies.
- 63. If deficiencies are identified in relation to the network services used by the firm, the firm shall:
 - (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

- 64. In circumstances when the firm intends to use services provided by a service provider in relation to its system of quality management, the firm shall: (Ref: Para. A148)
 - (a) Establish the nature and scope of the services, including the firm's responsibilities in using the services provided by the service provider; (Ref: Para. A149)
 - (b) Obtain an understanding of the service provider and the expected form, timing and content of communications between the firm and the service provider; (Ref: Para. A150)
 - (c) Determine that the reputation or technical competence, professional skills and professional values, ethics and attitudes of the service provider are appropriate in the context of the service provided; (Ref: Para. A151)
 - (d) Obtain an understanding of the service provider's processes in relation to the service, including how the service is evaluated and remediated; and (Ref: Para. A152)
 - (e) Conclude on whether it is appropriate to use the services of the service provider and periodically understand whether there are changes in the service provider's services or circumstances in relation to the matters in (a) to (d).
- 65. If deficiencies are identified in relation to the services provided by the service provider, either through the firm's monitoring activities or communications received from the service provider, the firm shall:
 - (a) Include the deficiency in the evaluation of the results of the external inspections and any other relevant information, as required by paragraph 48;
 - (b) Understand the planned remedial actions by the service provider and consider whether the service provider's remedial actions are effectively designed and implemented to address the deficiencies relevant to the firm and their related root cause(s);
 - (c) Determine the supplementary remedial actions needed by the firm, if any; and

- (d) Consider whether to continue using the services provided by the service provider.

Documentation

- 66. The firm shall prepare documentation of its system of quality management that is sufficient and appropriate to: (Ref: Para. A153–A155)
 - (a) Support a consistent understanding of the system of quality management by firm personnel, including an understanding of their roles and responsibilities with respect to the firm’s system of quality management;
 - (b) Support the consistent implementation and operation of the responses; and
 - (c) Provide evidence of the design, implementation and operation of the responses, such that the firm is able to evaluate the system of quality management.
- 67. The documentation shall include: (Ref: Para. A156)
 - (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 22(b);
 - (d) In relation to the monitoring and remediation process:
 - (i) Evidence of monitoring activities performed;
 - (ii) The evaluation of the findings from the monitoring activities, results of external inspections and other relevant information, including the identified deficiencies and their related root cause(s);
 - (iii) Remedial actions to address deficiencies and their related root cause(s), and the evaluation of the effectiveness of such remedial actions;
 - (v) Communications in relation to monitoring and remediation;
 - (vi) The evaluation of whether the system of quality management provides the firm with reasonable assurance in accordance with paragraph 15.
 - (e) [Placeholder for engagement quality control review]
- 68. In circumstances when the firm uses network services or service providers, the documentation shall include:
 - (a) The network services or other services used by the firm in its system of quality management, to the extent that they include the matters set out in paragraph 67;
 - (b) The firm’s basis for concluding on the appropriate use of the services.
- 69. The firm shall establish a period of time for the retention of documentation in relation to the system of quality management that is for a period of time sufficient to permit those performing monitoring procedures to evaluate the firm’s compliance with its system of quality control, or for a longer period if required by law or regulation.

Application and Other Explanatory Material

Scope of this ISQC (Ref: Para. 2)

- A1. Other pronouncements of the IAASB, including ISRE 2400 (Revised)⁶ and ISAE 3000 (Revised),⁷ also establish requirements for the engagement partner in relation to the management of quality at the engagement level.

The Firm's System of Quality Management (Ref: Para. 3–7)

- A2. Reasonable assurance is a high, but not absolute, level of assurance and is obtained when the firm's system of quality management reduces the risk that the objectives set out in paragraphs 15(a) and (b) are not achieved 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. Within the system of quality management, the components operate in an integrated manner. For example, the quality risk assessment process is the component through which the firm establishes quality objectives, identifies and assesses quality risks and designs and implements responses for the remaining components of the system of quality management. Similarly, the monitoring and remediation process is the component through which the firm evaluates the design, implementation and operation of the system of quality management, i.e., it monitors the other components of the system of quality management and remediates as appropriate. Furthermore, aspects of the components may overlap, for example, certain quality objectives within the relevant ethical requirements component may be considered when accepting or continuing client relationships and specific engagements. Paragraphs 1–2 of Appendix 1 further explain a system of quality management.
- A4. Professional judgment is necessary in relation to the design, implementation and operation of the entire system of quality management, including decisions about:
- The quality objectives that should be established.
 - The application of the threshold above which quality risks are identified.
 - The assessment of the quality risks.
 - The appropriate responses to address quality risks.
 - The nature, timing and extent of the monitoring activities to monitor the design, implementation and operation of the responses.
 - The evaluation of the results of the monitoring activities, external inspections and other relevant information.

⁶ International Standard on Review Engagements (ISRE) 2400 (Revised), *Engagements to Review Historical Financial Statements*

⁷ International Standard on Assurance Engagements (ISAE) 3000, *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*

- How to appropriately respond to the results of monitoring activities, external inspections and other relevant information, including the nature and extent of communications about the results.
- Whether the system of quality management provides the firm with reasonable assurance in accordance with paragraph 15.
- The conclusion on whether, and the extent to which, a network service or service provided by a service provider is appropriate for use in the firm's system of quality management.

The nature and circumstances of the firm, the engagements performed by the firm and the types of entities for whom the engagements are undertaken may affect the firm's judgments in relation to the system of quality management.

Definitions

Firm (Ref: Para. 16(i))

- A5. 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. 16(m))

- A6. The definitions of "network" or "network firm" in relevant ethical requirements may differ from the definitions 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.
- A7. In some instances, the network may concentrate or centralize processes or activities in a particular operating unit or location, for example, the network may centralize the independence function or provide resources that perform certain engagement procedures from a central location for multiple engagements across the network. Such centralized processes or activities may also be established by other firms within the network. Throughout this ISQC, in circumstances when reference is made to a network, it includes centralized processes or activities established by the network or another firm within the network, which are used by the firm.

Network Services (Ref: Para. 16(n))

- A8. The network may impose requirements on firms within the network that are expected to be implemented by the firms in order to be a member of the network. Such requirements may include:
- Adopting the policies or procedures established by the network at the firm level and supplementing those policies or procedures, as necessary, in order to address the firm's jurisdictional circumstances.

- Specifying how the firm's governance structures should be established and how the firm's leadership is expected to interact with the network.
 - Prescribed quality objectives, quality risks and responses established at the network level, which are supplemented at the firm level with quality objectives, quality risks and responses addressing the firm's unique circumstances.
 - Being subject to the network's monitoring activities. In some instances these monitoring activities may relate to services provided by the network (e.g., monitoring related to the methodology that is developed and maintained by the network), and in other instances they may relate to monitoring of responses implemented at the firm level.
- A9. The assistance provided by, or available from, the network may include services that the firm is not required to implement, but may choose to do so. For example, the network may develop training modules that firms within the network may use voluntarily.
- A10. The network may provide other information that is relevant to the firm, for example, information about the findings from monitoring activities or results of external inspections in relation to other firms within the network, which may be relevant when the other network firms perform work in relation to the firm's engagements, such as in the capacity of a component auditor.

Response (Ref: Para. 16(w))

- A11. Policies are implemented through the actions of the firm and its personnel, or through their restraint from taking actions that would conflict with such policies.
- A12. Procedures may be mandated, through formal documentation or other communication, or may result from behaviors that are not mandated but are conditioned by the firm's culture.
- A13. This ISQC establishes requirements that set out the responses the firm is required to implement in relation to the quality risk assessment process and monitoring and remediation process.

Applying, and Complying with, Relevant Requirements (Ref: Para. 17–18)

- A14. In some instances the individual(s) assigned ultimate responsibility and accountability for the system of quality management may have operational responsibility for the system of quality management. There may also be circumstances when the individuals(s) assigned operational responsibility for independence and monitoring are the same as the individual(s) assigned ultimate responsibility and accountability for the system of quality management or the individual(s) assigned operational responsibility for the system of quality management, such as in the case of a smaller firm.
- A15. The requirements are designed to enable the firm to achieve the objective of this ISQC stated in paragraph 15. 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. Paragraph 4 of Appendix 1 provides examples of the requirements of this ISQC that may not be relevant in the circumstances of a sole practitioner.

System of Quality Management (Ref: Para. 19)

- A16. In order for the firm to achieve the objective stated in paragraph 15, this ISQC requires the firm to establish eight components that operate in an integrated manner, i.e., all eight components collectively reduce, to an acceptable level, the risk of the system of quality management not achieving

the objectives in paragraph 15(a) and (b). The eight components are interdependent and have a multitude of interrelationships and linkages among them. 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.
- The quality risk assessment process is the component through which the firm establishes quality objectives, identifies and assesses risks and designs and implements responses. This process is applied to the other components of the system of quality management, with the exception of the monitoring and remediation process.
- The monitoring and remediation process is the component through which the firm monitors the system of quality management and remediates identified deficiencies. In doing so, the firm evaluates all of the components of the system of quality management, including the monitoring and remediation component itself.
- The firm’s decisions in relation to one component may affect the quality risks and responses of another component. For example, the firm may centralize the performance of certain engagement procedures in a central location for multiple engagements, in response to a quality risk relating to the firm’s resources. However, doing so may create new risks within the engagement performance component for which a response is necessary, such as appropriate direction and supervision of the personnel in the central location.

A17. There are a variety of factors that may affect the firm’s system of quality management that the firm may take into consideration in designing and implementing the system of quality management, including when identifying quality risks that affect the achievement of the firm’s quality objectives. Examples of the internal and external factors include:

Internal Factors	External Factors
<ul style="list-style-type: none"> • The size and operating characteristics of the firm, including the firm’s strategic decisions, such as those in relation to financial and operational matters, the geographical dispersion and the extent to which the firm concentrates or centralizes its processes or activities. • The nature of the engagements provided by the firm (e.g., the firm performs only compilation engagements or performs a variety of engagements, including audits of financial statements). • The nature of the entities to whom such engagements are undertaken or the industries in which they operate (e.g., engagements provided to owner-managed entities, entities that are listed 	<ul style="list-style-type: none"> • The firm’s stakeholders, for example, users of the firm’s reports, regulatory authorities, preparers and those charged with governance. • Professional standards, laws, and regulations. • Economic stability and social factors.

<p>entities or entities that are of significant public interest).</p> <ul style="list-style-type: none"> • In circumstances when the firm is within a network, the nature of the network, how the network is organized, the nature of what is performed at the network level, the network's requirements and expectations for the network firms, and the nature of what is provided by the network and the extent to which the firm uses it. 	
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Governance and Leadership (Ref: Para. 20–23)

- A18. The governance and leadership component provides the basis for the system of quality management, because the firm needs to organize itself, including its structure and assignment of responsibility, in order that the other components of the system of quality management can be developed. For example, in order to establish a system of quality management, the firm needs to identify the individual(s) responsible for its development. The governance and leadership component has a pervasive effect on the system of quality management, since it establishes the overall environment in which the system operates, including the structures that exist within the firm, the overall culture of the firm, the assignment of responsibility and how resources are obtained or allocated.
- A19. 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.

Culture (Ref: Para. 20(a) and 22(a)(i))

- A20. The firm's culture is an important factor in influencing the behavior of the firm's personnel, while at the same time accomplishing the firm's financial and operational 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.
- A21. A 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 individual(s) assigned ultimate responsibility and accountability for the system of quality management through their personal conduct, communication and actions. 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 nature and extent of the actions of the individual(s) assigned ultimate responsibility and accountability for the system of quality management in establishing a culture 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 the direct interaction of firm leadership with the firm's personnel. Paragraph 5 of Appendix 1 provides examples of the actions that may be undertaken by the individual(s) assigned ultimate responsibility and accountability for the system of quality management to foster a culture of quality throughout the firm. Paragraph 6 of Appendix 1 explains how the culture of the firm may be influenced and supported by the network in circumstances when the firm belongs to a network.

Strategic Decisions and Actions and Relevant Stakeholders (Ref: Para. 20(c) and 22(a)(ii))

- A22. The firm may have a variety of 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. Relevant stakeholders with a legitimate interest are ordinarily those stakeholders who are affected by, or rely on, the work performed by the firm. For example, in the case of a firm that performs audits of financial statements of listed entities or entities that are of significant public interest, relevant stakeholders with legitimate interests ordinarily include shareholders and credit providers of such entities, as well as management and those charged with governance. On the other hand, the relevant stakeholders for a firm that only performs independent reviews of financial statements of non-listed entities or entities that are not of significant public interest may be more limited and would ordinarily include the entities' management and credit providers.
- A23. It is important that the firm's strategic decision-making process, which may include establishing a business strategy, takes into consideration 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. For example, the firm's decisions in relation to its business strategy may focus on the growth of non-assurance services (e.g., advisory or consulting services), that may affect how the firm obtains and allocates its resources, and may create competing priorities for the firm personnel between financial and operational priorities and achieving quality.
- A24. 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. Paragraph 28(f) addresses communication with parties external to the firm about the firm's system of quality management.

Organization of the Firm and Resources (Ref: Para. 20(d) and 22(a)(iv))

- A25. 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 types of engagements the firm provides; and

- Designating authority and responsibility within the firm.
- A26. The internal firm structure includes leadership and management as well as its organizational structure. Smaller firms may have simple leadership and management 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 managing partner (or equivalent), managing board of partners (or equivalent) or other individual(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. Paragraph 7 of Appendix 1 includes examples of matters that may be considered in relation to the leadership and management structure of the firm.
- A27. In establishing the firm's leadership and management structure, the firm may consider:
- The required knowledge, experience, time and authority within the firm necessary to fulfill the identified roles; and
 - The need for other attributes that contribute to the firm's commitment to quality.
- A28. The organizational structure of the firm varies depending on its size and operating characteristics and may include operating units, operational processes, divisions or geographical locations and other structures the firm uses to achieve its quality objectives. In some instances, the firm may concentrate or centralize processes or activities in a particular operating unit or location, for example, performing certain engagement procedures from a central location for multiple engagements.

Resources

- A29. 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. In order to achieve the firm's strategic goals the firm obtains, uses and allocates its resources in a manner that supports the achievement of such goals, which includes the firm's commitment to quality. Those assigned ultimate responsibility and accountability for the system of quality management are in a unique position to influence the nature and extent of resources that the firm obtains and maintains, and how the firm's resources are allocated, including the timing of when they are used. Resources include those set out in paragraph A81.

Firm Leadership Responsibility and Accountability (Ref: Para. 20(b) and 22(a))

- A30. 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 some circumstances, there may be one individual who has responsibility for overseeing the firm's operations and allocating resources, for example, a chief executive officer or a managing partner. In other circumstances, responsibility for overseeing the firm's operations and allocating resources may be assigned to a group of individuals, for example, a managing board of partners.

Operational Responsibility (Ref: Para. 22(a)(iii))

- A31. The individual(s) assigned ultimate responsibility for the system of quality management is responsible and accountable for the system achieving the objective in accordance with paragraph 15. The

individual(s) assigned operational responsibility for the system of quality management as a whole is responsible and accountable for the design, implementation and operation of the firm's system of quality management. In some instances, operational responsibility for all of the matters in paragraph 22(a)(iii) may be assigned to one individual, particularly in the case of a smaller firm, or the individual(s) assigned ultimate responsibility for the system of quality management may assume all of these responsibilities.

- A32. The accountability of those assigned operational responsibility for the firm's system of quality management is established through periodic performance evaluations that assess the effectiveness of such individual(s), as required by paragraph 22(b), 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 that will be used to evaluate the results of the firm's monitoring activities, and evaluating such measures against targets.
 - Establishing appraisal and reward systems that address the responsibilities of such individual(s) and promote personal characteristics that support and reinforce the firm's view on the importance of quality.
- A33. In some cases, the firm may assign responsibility for specific aspects of the system of quality management, in addition to assigning operational responsibility for the matters set out paragraph 22(a)(iii). For example, the individual who has operational responsibility for independence may also be assigned broader responsibility related to the firm's compliance with all relevant ethical requirements.
- A34. The firm may consider whether additional criteria in relation to the eligibility of the individual(s) assigned operational responsibility for the matters set out in paragraph 22(a)(iii) are necessary, in the circumstances of the firm. For example, in some cases, such as a larger firm, it may be appropriate for the individual(s) assigned operational responsibility for matters related to independence to be autonomous from the service lines within the firm, in order that decisions in relation to independence are undertaken in an impartial manner.

Performance Evaluations (Ref: Para. 22(b))

- A35. The performance evaluations apply to the individual(s) assigned ultimate responsibility for the system of quality management and the individual(s) assigned operational responsibility for the matters set out in paragraph 22(a)(iii). Given the unique position of the individual(s) assigned ultimate responsibility for the system of quality management, the performance evaluations may be undertaken by the firm's network, an independent non-executive member of the firm's governing body or a special committee overseen by the firm's governing body or the firm may appoint an external service provider to perform the evaluation. 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 may provide an indication of the performance of the assigned ultimate responsibility for system of quality management and the individual(s) assigned operational responsibility for the matters set out in paragraph 22(a)(iii).
- A36. Periodic performance evaluations of individual(s) within the firm may promote accountability of such individual(s) for the responsibilities assigned to them 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 in relation to aspects of the system of quality management that relate to the responsibility of the individual, for example, independence in relation to the individual(s) assigned operational responsibility for independence;
 - The actions taken by the individual(s) in response to deficiencies identified that relate to their area of responsibility and their related root causes and the effectiveness of such actions.
- A37. 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 incentives. 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 that may affect the firm's achievement of its quality objectives.

Quality Risk Assessment Process (Ref: Para. 24–26)

A38. The quality risk assessment process is the component through which the firm establishes quality objectives, identifies and assesses quality risks and designs and implements responses. This process is applied to the other components. This ISQC does not require the firm to apply the quality risk assessment process to the monitoring and remediation component, although the firm may voluntarily do so. Instead, this ISQC establishes requirements in relation to the monitoring and remediation process that set out the policies or procedures that the firm is required to implement in order to establish an effective monitoring and remediation process.

Establish Quality Objectives (Ref: Para. 25(a))

A39. 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 nature and circumstances of the firm, the engagements performed by the firm and the types of entities for whom the engagements are undertaken. The firm applies professional judgment in determining whether additional or more granular quality objectives are necessary in the circumstances of the firm. Paragraph 8 of Appendix 1 explains circumstances when more granular quality objectives may be appropriate.

Identify and Assess Quality Risks (Ref: Para. 25(b))

- A40. The firm applies professional judgment in identifying and assessing the quality risks, including when making decisions about whether risks meet the threshold above which quality risks are identified and the assessment of the quality risks. The process may involve a combination of ongoing and periodic risk identification and assessment procedures, including:
- Identifying the risks that need to be addressed by the firm in order to reduce the risk to an acceptably low level, i.e., those risks that have a reasonable possibility of occurring and a reasonable possibility of causing a quality objective(s) not to be achieved. There is a reasonable possibility of a risk occurring when the likelihood of its occurrence is more than remote. Similarly there is a reasonable possibility of the risk causing a quality objective(s) not to be achieved when the likelihood of the quality objective not being achieved is more than remote.
 - Assessing the quality risks for the purpose of designing a response that appropriately addresses the quality risk.

- A41. Under this ISQC, not every risk needs to be addressed by the firm, i.e., when the likelihood of a risk occurring is less than remote or the likelihood of the risk causing a quality objective to not be met is less than remote, the firm need not address that risk. Such risks are not considered to be a quality risk. In determining whether a quality risk has a reasonable possibility of occurring and a reasonable possibility of causing a quality objective(s) not to be achieved, the firm understands and considers the conditions, events, circumstances, actions or inactions that give rise to the risk. The conditions, events, circumstances, actions or inactions that give rise to a quality risk may arise from one or more of the factors set out in paragraph A17.
- A42. The assessment of the quality risks ordinarily focuses on understanding the likelihood of the quality risks, taking into account the identified conditions, events, circumstances, actions or inactions, and the degree to which the quality risks would affect the achievement of the quality objectives should they occur. It need not comprise formal ratings or scores. In assessing the likelihood of the quality risks, the firm may consider the expected frequency of its occurrence. In assessing the degree of the effect of the quality risk on the achievement of the quality objective, the firm may consider:
- The rate at which the effect of the quality risk would take place, or the amount of time that the firm has to respond to the quality risk.
 - The duration of time of the effect of the quality risk after it has occurred.

Paragraphs 9 and 10 of Appendix 1 provide examples of how the rate at which the effect of a quality risk takes place, the amount of time that the firm has to respond to a quality risk or the duration of time of the effect of the quality risk after it has occurred, may affect the firm's assessment of a quality risk.

Design and Implement Responses to Quality Risks (Ref: Para. 25(c))

- A43. The firm applies professional judgment in designing and implementing responses to address the quality risks, for example, when making decisions about the most appropriate response to address a quality risk. The responses designed and implemented by the firm are required to include certain responses set out in this ISQC, i.e., the responses in paragraphs 22, 29, 34, 37, 40, and 43. The firm's responses, including the required responses, are required to be designed and implemented in a manner that 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).
- A44. The responses designed and implemented by the firm may operate at the firm level or engagement level, or there may be supplementary actions needed at an engagement level in order for a response to operate as designed. For example, the firm may appoint suitably qualified and experienced personnel to provide technical advice to engagement teams, and in doing so may prescribe specific matters that need to be consulted on by the engagement team. However the engagement team has a responsibility to identify when such matters occur and to initiate such consultation as required by the firm's policies or procedures. Communicating to engagement teams their responsibilities for the implementation and operation of responses is therefore important for the functioning of the system of quality management. ISA 220 (Revised), ISRE 2400 (Revised) and ISAE 3000 (Revised) establish

requirements for the engagement partner in relation to the management of quality at the engagement level. ISA 220 (Revised) further requires that [*placeholder to set out specific requirements of ISA 220 (Revised) when it is finalized*].

A44a. 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. Paragraph A110 further explains the difference between responses designed to detect deviations and responses that are considered part of the firm's monitoring activities.

Nature, Timing and Extent of the Firm's Response

A45. The nature, timing and extent of the response is dependent on factors such as:

- The firm's assessment of the quality risk, i.e., how likely it is to occur and the degree to which it may affect the achievement of the quality objectives. A quality risk that has a higher probability of occurring or a may have an extensive effect on the achievement of a quality objective may require a more rigorous response from the firm in order to reduce the risk to an acceptably low level.
- The nature of the risk, i.e., the conditions, events, circumstances, actions or inactions that give risk to 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.
- 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.

In some cases, the firm may design and implement a response that addresses multiple quality risks across multiple components. Paragraph 11 of Appendix 1 provides examples of factors that may be considered by the firm in relation to the design of a response.

A46. Structured documentation of the firm's responses may not be necessary in all circumstances. For example, the firm may establish policies or procedures that are stated in communications or implied through the actions of firm leadership. However, when policies or procedures are not formally documented, it may be possible that firm personnel are not aware of such policies or procedures or they might not be followed. 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.

A47. The responses designed and implemented to address a quality risk in one component may affect the quality risks and responses of another component. For example, the implementation of new engagement software may create new quality risks within the engagement performance component for which a response is necessary, such as increased direction, supervision and review at the engagement level.

Determining Whether the Quality Objectives, Quality Risks and Responses Remain Appropriate (Ref: Para. 26)

A48. Quality objectives, quality risks or responses in relation to a component or components may need to be revised when changes occur 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 and other internal or external factors, such as new or amended law, regulation, or professional standards. They also are revised as a result of deficiencies identified through the firm's monitoring activities, external inspections or other relevant information. Since the eight components of the system of quality management are inter-related, any revisions to the quality objectives, risks or responses in one component may affect other components.

Information and Communication (Ref: Para. 27–29)

A49. 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.

A50. Relevant and reliable information includes information that is accurate, complete, timely and valid to support the proper functioning of the firm's system of quality management. Paragraph 29(a) requires the firm to establish policies or procedures to address the identification, capture, process and maintenance of information. Such policies or procedures may identify and define the information needs to support the operation of the components of the system of quality management and level of specificity of such information. The information systems that enable the operation of such policies or procedures may be manual or automated, and may be integrated. The range and sophistication of such information systems may depend on factors such as the complexity and volume of the information, the source of the data, how the information will be used and disseminated, including the timeliness in which the information is needed, or the size and complexity of the firm. Information systems, or how the data is obtained, may be embedded within the firm's responses, for example, the firm's audit software tool may enable the firm to obtain information relevant to the operation of the system of quality management. Paragraph 12 of Appendix 1 provides examples of the information that is relevant in supporting the functioning of the components of the system of quality management.

A51. Communication is the means through which the firm and its personnel share relevant information throughout the firm 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. For example, information that is obtained during the firm's acceptance and continuance process may be relevant to planning and performing the audit engagement in accordance with the ISAs, or may be relevant to the engagement team in order to fulfill their responsibilities under ISA 220 (Revised). Accordingly, such information may be communicated to engagement teams. As the engagement progresses, the engagement partner may need to update the firm's information about the client, such as in respect of changes in the client's organizational structure.
- Personnel performing duties in relation to the operation of the firm's system of quality management, including the individual(s) assigned ultimate responsibility and accountability or the individual(s) assigned operational responsibility for the firm's system of quality management.

- Parties that are external to the firm, which 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.

Such two-way communication may also be among firm personnel or between firm personnel, and with external parties. Paragraphs 13–17 of Appendix 1 provide examples of the matters that may be communicated between the firm and firm personnel or external parties, or among them, and it explains the methods of communication that may be used in various circumstances.

- A52. Paragraph 55 requires the firm to communicate on a timely basis to firm personnel information in relation to the firm's monitoring and remediation process that is relevant to their responsibilities, i.e., when the firm identifies information arising from its monitoring and remediation process that is relevant to the firm personnel, such information is communicated in a timely manner. Such communications may form part of the annual communication to firm personnel of matters related to the firm's system of quality management. Paragraph A63 sets out other information that may be communicated on an annual basis.

Complaints and Allegations (Ref: Para. 29(e))

- A53. Establishing channels that enable reporting of complaints and allegations and policies or procedures to deal with them supports the firm's culture that promotes a commitment to quality, including professional values, ethics and attitudes.
- A54. Complaints and allegations may originate from within or outside the firm and they may be made by firm personnel, clients or other third parties. Complaints and allegations 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. A complaint or allegation may indicate that there is a deficiency in the system of quality management that would be considered in accordance with paragraph 48.
- A55. Law, regulation or relevant ethical requirements may establish responsibilities for the firm or its personnel in circumstances where complaints or allegations arise, such as an obligation on the firm to report the matter to an authority outside the firm. For example, section 260 of the IESBA Code addresses the professional accountant's responsibility in relation to non-compliance with laws or regulations that may be relevant in circumstances when the work performed by the firm or the actions of the firm or its personnel has resulted in non-compliance with laws or regulations.
- A56. In identifying an appropriate individual(s) within the firm to whom complaints and allegations are communicated, the firm may take into consideration factors such as whether the individual(s) has:
- The experience, knowledge, time and appropriate authority within the firm needed to assume the role; and
 - A direct reporting line of communication to the individual(s) assigned ultimate responsibility for the system of quality management.
- A57. The firm may also establish policies or procedures for the identification of an individual(s) responsible for supervising the investigation of the complaint that take into consideration whether the individual(s):
- Has the experience, knowledge, time and appropriate authority within the firm to undertake the investigation; 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 individual(s) supervising the investigation may involve legal counsel as necessary. In the case of a smaller 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.

Communication with External Parties

- A58. The firm may communicate information about the firm's system of quality management to parties external to the firm in a variety of ways, for example, through transparency reports, audit quality reports or marketing publications. In some circumstances, the firm may communicate specific information directly to external parties that is not made available publicly, for example, information about the results of the firm's monitoring and remediation process may be communicated directly to external parties.
- A59. Relevant stakeholders may include shareholders and credit providers of the entities to whom the firm provides services. Information about the firm's system of quality management may also be useful for (i) other firms when such firms use the work of the firm in the performance of engagements (e.g., in relation to a group audit), or (ii) management or those charged with governance (e.g., in evaluating how the firm manages the quality of the firm's engagements as a basis for determining whether to appoint the firm).
- A60. The nature of the engagements the firm performs and the types of entities for whom such engagements are performed may affect the nature, timing and extent of the communication to external parties. For example, the firm may determine it appropriate to prepare a publication with information about its system of quality management that is publicly available in circumstances when the firm performs audits of financial statements of listed entities or entities that may be of significant public interest, for example because they have a large number and wide range of stakeholders or due to their nature and size of the business. Examples of such entities may include financial institutions (such as banks, insurance companies, and pension funds), and other entities such as charities.
- A61. Paragraph 29 requires the firm to establish quality objectives that address the communication of information externally that is relevant and timely. Information that is relevant and timely may possess attributes such as being:
- Specific to the circumstances of the firm and prepared and presented in a timely manner. Relating the matters in the firm's communication directly to the specific circumstances of the firm may help to minimize the potential that such information become overly standardized and less useful over time.
 - Presented in a clear and understandable manner that is neither misleading nor would inappropriately influence the users of the communication; and
 - Accurate and complete in all material respects and does not contain information that is misleading.

- A62. In determining the content of the information communicated about the firm's system of quality management, the firm may take into consideration:
- The requirements of law or regulation or other professional standards.
 - The information needs of the users for whom the communication is intended. In considering what information is useful for the users' of the firm's communications, the firm may take into consideration matters such as the level of detail that users would find meaningful and whether users have access to relevant information through other sources, for example, information located on the firm's website.
 - The nature and circumstances of the firm, the engagements performed by the firm and the types of entities for whom the engagements are undertaken.
- A63. Information that may be communicated about the firm's system of quality management may focus on how the firm has responded to emerging developments and changes in its circumstances, including how the system of quality management has been adapted to respond to such changes. Other information that may be communicated includes:
- A description of the firm's structure, including the structure of its network.
 - A description of the firm's leadership structure and profiles of the individuals within firm leadership.
 - Information about the firm's measures to support engagement quality, such as:
 - An overview of the responses the firm has implemented to address governance and leadership, including information about the firm's culture that promotes a commitment to quality;
 - An overview of the firm's information and communication, including how it has established effective two-way communication within the firm and its engagement with external stakeholders;
 - An overview of the quality risks that have been assessed as more severe or pervasive and the responses the firm has designed and implemented to address such risks;
 - An overview of the firm's monitoring activities and its process for identifying and evaluating deficiencies; or
 - In circumstances when the firm belongs to a network, the nature of the services that the firm uses which are provided by the network.
 - The extent to which the firm uses service providers in relation to its system of quality management.
 - The results of the firm's monitoring and remediation process in accordance with paragraph 56, or, if paragraph 58 is relevant, an indication that the firm has not achieved reasonable assurance in accordance with paragraph 15.
 - Information about the firm's internal indicators of engagement quality.
- A64. In some cases, the firm may describe the limitations of the information provided, for example, if the firm presents information about the firm's internal indicators of engagement quality, the firm may

consider explaining the limitations of such indicators, including that the indicators may not be comparable across firms, or between periods.

Relevant Ethical Requirements (Ref: Para. 32–34)

A65. Relevant ethical requirements establish the principles of professional ethics, which ordinarily include:

- (a) Integrity;
- (b) Objectivity;
- (c) Professional competence and due care;
- (d) Confidentiality; and
- (e) Professional behavior.

For example, Section 110 of the IESBA Code sets out the fundamental principles of ethics that establish the standard behavior expected of a professional accountant. Section 120 of the IESBA Code includes the conceptual framework, which establishes the approach that an accountant is required to apply to assist in complying with those fundamental principles. Parts 2 and 3 of the IESBA Code set out additional material that address specific topics relevant to complying with the fundamental principles, for example, responding to non-compliance with laws and regulations and conflicts of interest.

A66. Relevant ethical requirements may also include provisions in relation to independence. For example, Parts 4A and 4B of the IESBA Code include specific provisions that require a firm to be independent when performing audits or reviews of financial statements or other assurance engagements. The IESBA Code sets out provisions that address specific circumstances when threats to the firm's independence may arise, for example, provisions addressing financial interests and relationships, the provision of non-assurance services to an audit client and the long association of personnel with an audit or assurance client. 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.

A67. Paragraph 34 includes responses that the firm is required to implement to address quality risks in relation to relevant ethical requirements, including independence requirements. For example, obtaining confirmations of compliance with the independence requirements from firm personnel supports the firm in addressing compliance with independence requirements, demonstrates the importance that the firm attaches to independence and makes the issue current for, and visible to, its personnel. The responses in other components of this ISQC may also address the fulfillment of relevant ethical requirements, for example, paragraph 29 of this ISQC contains required responses addressing information and communication to support the operation of the components of the system of quality management. This includes responses for information and communication to support the operation of the relevant ethical requirements component, such as:

- Communicating the independence requirements to all firm personnel and others subject to independence requirements, as applicable (including network firm personnel).
- Establishing policies or procedures for personnel to communicate relevant information to appropriate parties within the firm or to the engagement partner, such as:

- Communicating information about client engagements and the scope of services, including non-assurance services, to enable the firm to identify threats to independence during the period of the engagement and during the period covered by the subject matter.
- Communicating circumstances and relationships that may create a threat to independence, so that the firm can evaluate whether such a threat is at an acceptable level and if it is not, address the threat by eliminating it or reducing it to an acceptable level.
- Prompt communication of any breaches of the relevant ethical requirements, including the independence requirements.
- Establishing information systems that record and maintain information in relation to independence.

Other responses that the firm may design to address the quality risks include, for example, establishing policies and procedures that set out the appropriate length of service of personnel performing audits or reviews of financial statements or other assurance engagements, taking into consideration the requirements of relevant ethical requirements and the associated quality risk.

- A68. In evaluating whether an identified threat is at an acceptable level, the firm may consider whether a reasonable and informed third party, who weighs all the relevant facts and circumstances that the firm knows, or could reasonably be expected to know, at the time the evaluation is made, would likely conclude that the firm complies with the principles of the relevant ethical requirements.
- A69. In circumstances when the identified threats are not at an acceptable level, the threats may be addressed by:
- Eliminating the circumstances that are creating the threat;
 - Reducing the threat to an acceptable level through applying safeguards; or
 - Declining or ending the engagement.
- A70. Relevant ethical requirements may include specific requirements regarding how the firm is required to respond to a breach of the relevant ethical requirements, including the independence requirements. For example, the IESBA Code⁸ sets out requirements for the firm in the event of a breach of the independence requirements, which includes communication with those charged with governance of the client.
- A71. [*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.

⁸ See paragraphs R400.80–R400.87 of the IESBA Code.

Acceptance and Continuance of Client Relationships and Specific Engagements (Ref: Para. 35–37)

The Nature and Circumstances of the Engagement (Ref: Para. 35(a))

A71a. The information obtained regarding the nature and circumstances of the engagement may include matters such as:

- The industry of the entity for whom the engagement is being undertaken and relevant regulatory factors;
- The nature of the entity, for example, its operations, organizational structure, ownership and governance, its business model and how it is financed; and
- The applicable criteria to be applied to the subject matter information (e.g., the applicable financial reporting framework in the case of an audit of financial statements).

Integrity and Ethical Values of the Client, including Management, and, When Appropriate, Those Charged with Governance (Ref: Para. 35(a), 35(b) and 37(a))

A72. The extent of information regarding the integrity and ethical values of the client needed to support the firm's judgment about the acceptance or continuance of client relationships and specific engagements depends on various factors, for example, the nature of the entity for whom the engagement is being performed, including the complexity of its ownership and management structure. Paragraph 20 of Appendix 1 provides examples of the information that the firm may obtain or consider in relation to the integrity and ethical values of the client.

A73. 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 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.

Paragraph 21 of Appendix 1 provides examples of other sources of information.

A74. The firm may need to communicate the information obtained about the nature and circumstances of the engagement and the integrity and ethical values of the client, including management, and, when appropriate, those charged with governance to the engagement team as it may be relevant to the performance of the engagement. For example, ISA 315 (Revised)⁹ requires the engagement team, in identifying risks of material misstatement, to take into account information obtained from the client acceptance or continuance process.

A75. Relevant ethical requirements may require the firm to make inquiries of an existing or predecessor firm when accepting an engagement. For example, the IESBA Code¹⁰ requires the firm to make inquiries of an existing or predecessor firm when accepting an engagement that is an audit or review of financial statements. The IESBA Code¹¹ also requires the predecessor auditor, on request by the

⁹ ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

¹⁰ Paragraph R320.8 of the IESBA Code.

¹¹ Paragraph R360.22 of the IESBA Code.

proposed successor auditor, to provide information regarding identified or suspected non-compliance with laws and regulations to the proposed successor auditor.

- 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. 35(c))

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 knowledge of the entity's industry;
- Is able to fulfill relevant ethical requirements; and
- Has the time and resources to perform the engagement.

Paragraph 22 of Appendix 1 provides examples of factors the firm may consider in relation to its ability to perform the engagement.

- A78. Relevant ethical requirements may include specific requirements that need to be considered before accepting or continuing a client relationship or specific engagement. For example, the IESBA Code¹² requires that reasonable steps be taken to identify circumstances that might create a conflict of interest before accepting a new client relationship and further requires remaining alert to changes in the nature of services, interest and relationships that might create a conflict of interest. The IESBA Code also requires the firm to consider conflicts of interest that might exist or arise due to interests and relationships of a network firm in circumstances when the firm is a member of a network.

Withdrawal from an Engagement (Ref: Para. 35(d))

A79. The firm's response to address circumstances when information becomes available to the firm that may have affected the firm's decision to accept or continue a client relationship or specific engagement may include establishing policies or procedures that set out the actions to be taken when such information becomes available, such as:

- Undertaking appropriate consultation within the firm or with legal counsel.
- Considering whether there is a professional, legal or regulatory requirement for the firm to continue the engagement.
- 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.
- If the firm withdraws from the engagement, considering whether there is a professional, legal or regulatory requirement for the firm to report the withdrawal from the engagement, or from

¹² Paragraphs R310.5 and R310.6 of the IESBA Code.

both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities.

Circumstances when the Firm is Obligated to Accept or Continue a Client Relationship or Specific Engagement (Ref: Para. 37(c))

A80. There may be circumstances when the firm is obligated to accept or continue a client relationship or specific engagement despite there being information that would have caused the firm to decline the engagement. For example, jurisdictional laws and regulations may impose an obligation on the firm to accept or continue a client engagement, or in the case of the public sector, auditors are appointed through statutory procedures. In such circumstances, the firm adapts the performance of the engagement, for example, by adjusting the nature, timing and extent of the procedures undertaken during the engagement to respond to the information. However, it may not be possible to adapt the procedures such that the firm is satisfied that the matter is adequately addressed and the firm may therefore respond by appropriately addressing the issue in the engagement report. For example, in an audit of financial statements if the firm is concerned with the integrity of management, the firm may determine that it is unable to rely on the representations of management (written or oral) and audit evidence more generally.¹³

Resources (Ref: Para. 38–40)

A81. 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

A82. Financial resources are necessary for obtaining, developing and maintaining the human resources, technological resources and intellectual resources that are needed to support the functioning of the firm's system of quality management and the performance of engagements. The IESBA Code¹⁴ explains that a self-interest threat to compliance with the fundamental principle of professional competence and due care may arise if the fee quoted for an engagement is so low that it might be difficult to perform the engagement in accordance with professional standards.

A83. Given that resources are obtained and developed over time, it is necessary for the firm to anticipate its future resources needs. Resource needs may change over time as a result of 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. The resources themselves may also change, for example, the firm may experience a high staff turnover that affects how the firm allocates its resources to engagements. Paragraph 22(a)(iv) requires the individual(s) assigned ultimate responsibility for the system of quality management to be responsible for obtaining and allocating resources in a manner that supports the firm's strategic decisions and actions and the effective design, implementation and operation of the firm's system of quality management.

¹³ See paragraphs 18 and 20 of ISA 580, *Written Representations*

¹⁴ Paragraph 330.3 A2 of the IESBA Code.

Human Resources (Ref: Para. 38(b)–38(d) and 40(a)–40(d))

A84. Attracting, developing and retaining human resources ordinarily involves the following processes:

- Recruitment. Recruitment strategies that support the firm’s system of quality management may include a focus on selecting individuals who have the ability to develop the technical competence, professional skills and professional values, ethics and attitudes necessary to perform engagements and other duties within the firm.
- Training and continuing professional development. Training programs and actions that encourage firm personnel to engage in continuing professional development support the performance of engagements.
- Performance evaluation.
- Career development and promotion.
- Compensation.

A85. The International Education Standards (IES), which are issued by the International Accounting Education Standards Board (IAESB), establish standards for professional accounting education that prescribe the technical competence and professional skills, values, ethics, and attitudes for professional accountants, and may provide useful guidance for the firm in determining the appropriate technical competence, professional skills and professional values, ethics and attitudes of its personnel. For example, IES 7¹⁵ includes requirements for the continuing professional development of professional accountants and IES 8 (Revised)¹⁶ prescribes the professional competence that professional accountants are required to develop and maintain when performing the role of an engagement partner for an audit of financial statements. Paragraph 23 of Appendix 1 provides examples of how the professional values, ethics and attitudes of firm personnel may be developed.

A86. When assigning personnel to engagements or other roles, the firm may organize its personnel in a variety of ways. In some circumstances, the firm may concentrate or centralize its processes or activities in a particular operating unit or location, for example, certain engagement procedures may be performed for multiple engagements in a centralized location. The firm may also determine it appropriate to obtain specialist skills from other network firms or service providers, such as other professional services firms. In such cases, the firm may need to design responses to address the objectives in this ISQC in relation to human resources, to the extent that they apply to such individual(s), for example, how the firm establishes that such individual(s) have the technical competence, professional skills and professional values, ethics and attitudes to effectively perform the engagement. Paragraph 24 of Appendix 1 provides examples of how the firm may assign its personnel to engagements and paragraph 25 of Appendix 1 includes factors that the firm may consider when assigning personnel to engagements and determining the level of supervision required.

A87. 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

¹⁵ IES 7, Continuing Professional Development (2014)

¹⁶ IES 8, Professional Competence for Engagement Partners Responsible for Audits of Financial Statements (Revised)

responsibility for performing the engagement and supports their understanding of how to fulfill their responsibilities in accordance with professional standards. Furthermore, law or regulation may establish requirements for the professional licensing of engagement partners, including requirements regarding their technical competence, professional skills and professional values, ethics and attitudes.

- A88. The firm may evaluate 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 through undertaking performance evaluations. In doing so, the firm may also provide personnel with feedback and counseling on the individual's performance, progress and career development. Less formal methods of evaluation and feedback may be used, particularly in the case of smaller firms with fewer personnel. Nevertheless, timely evaluations and feedback help support and promote the continual development of the technical competence, professional skills and professional values, ethics and attitudes of firm personnel.
- A89. The firm's evaluations may be used by the firm in determining the promotion, compensation or other incentives of firm personnel that give due recognition and reward to firm personnel who demonstrate a commitment to quality and who maintain and develop the technical competence, professional skills and professional values, ethics and attitudes, to perform their role. The policies or procedures established by the firm that address compensation, promotion and other incentives with regard to firm personnel, may provide for simple or informal incentives that are not based on monetary rewards.

Technological Resources (Ref: Para. 38(e), 38(g) and 40(e))

- A90. The firm may develop technological resources internally, acquire technological resources from a service provider, or the firm's network may provide technological resources. Paragraphs 59–63 address circumstances when the firm uses network services and paragraphs 64–65 address circumstances when the firm uses a service provider. Paragraph 27 of Appendix 1 explains the frequency with which the firm may need to acquire, develop or maintain its technology and paragraphs 28–29 of Appendix 1 set out the responses the firm may implement when technology is acquired from a network or service provider and when it is developed internally.
- A91. The technology used by the firm encompasses the infrastructure and other resources necessary 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 affected by technological changes. Paragraphs 30–31 of Appendix 1 explain the importance of security in relation to the firm's technology, provide examples of the types of security measures that may be implemented and factors that may influence the security.
- A92. Engagement teams may need to be trained on how to use the technological resources appropriately and may be required to undertake specific actions so that 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 about the client and the circumstances of the engagement in order to generate an appropriate 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. 38(f), 38(g) and 40(f))

A93. 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. Paragraphs 59–63 address circumstances when the firm uses network services and paragraphs 64–65 address circumstances when the firm uses a service provider. Paragraphs 32–33 of Appendix 1 explain how the nature and extent of the firm’s intellectual resources may vary, and provide examples of responses addressing intellectual resources.

Engagement Performance (Ref: Para. 41–43)

Direction, Supervision and Review (Ref: Para. 41(a))

A94. 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.

A95. 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.

Judgments and Conclusions (Ref: Para. 41(b))

A96. Professional judgment is applied throughout the performance of engagements. The extent of professional judgment applied in an engagement depends on a variety of factors, for example, the nature of the engagement, the nature of the entity for whom the engagement is performed and the

underlying circumstances of the engagement (e.g., the complexity of the subject matter or subject matter information).

- A97. Although the judgments are undertaken at the engagement level, the system of quality management supports the quality of such judgments, for example, by creating an environment and culture that supports firm personnel in exercising judgment, providing support tools (e.g., guides and other resources) or through consultation or review (e.g., an engagement quality control review provides an objective evaluation of the judgments made by the engagement team and the conclusions reached).

Consultation (Ref: Para. 43(a))

- A98. Consultation typically involves a discussion at the appropriate professional level, with individuals within or outside the firm who have specialized expertise, on difficult or contentious matters. While the firm establishes policies or procedures regarding the matters on which consultation is required, the engagement team may identify matters that require consultation, for example, difficult or contentious matters specific to the engagement. The policies or procedures addressing consultation may provide clear guidelines as to the steps to be taken in consultation, and may set out documentation requirements. Paragraphs 34–35 of Appendix 1 explain factors that contribute to effective consultation and matters that may be included in the documentation.
- A99. 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. In such cases, paragraphs 64–65 apply.

Differences of Opinion (Ref: Para. 43(b))

- A100. The policies or procedures addressing differences of opinion may be established in a manner that encourages identification of differences of opinion at an early stage, provides clear guidelines as to the successive steps to be taken thereafter, and requires 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 Quality Control Reviews (Ref: Para: 43(c))

[Placeholder until ISQC 2 is further developed]

Engagement Documentation (Ref: Para. 41(d))

Completion of the Assembly of Final Engagement Files

- A101. 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. Paragraph 36 of

Appendix 1 explains circumstances when two or more different reports are issued in respect of the same subject matter information.

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

A102. 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.¹⁷ Specific laws or regulations may impose additional obligations on the firm's personnel to maintain client confidentiality, particularly where data of a personal nature is 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.

A103. 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. Paragraphs 37–38 of Appendix 1 provide examples of the responses the firm may design and implement to address unauthorized alteration or loss of engagement documentation and the maintenance of the confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation.

Retention of Engagement Documentation

A104. 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 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. Paragraph 39 of Appendix 1 provides examples of the responses the firm may design and implement to address retention of engagement documentation.

A105. 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 auditor's report on the group financial statements, when applicable.

Ownership of engagement documentation

A106. 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.

¹⁷ See, for example, paragraph R114.1, 114.1 A1 and R360.26 of the IESBA Code.

Monitoring and Remediation Process (Ref: Para. 44–58)

A107. In addition to supporting the firm's evaluation of the design, implementation and operation of the responses within 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. Professional judgment is applied in relation to various decisions within the monitoring and remediation process, including decisions about:

- The nature, timing and extent of the monitoring activities to monitor the design, implementation and operation of the responses, including the scope of inspection of completed engagements.
- The evaluation of the findings from the monitoring activities, results of external inspections and other relevant information.
- How to appropriately respond to the findings from the monitoring activities, results of external inspections and other relevant information.
- Whether the system of quality management provides the firm with reasonable assurance in accordance with paragraph 15.

Designing and Performing Activities to Monitor the Design, Implementation and Operation of the Responses (Ref: Para. 45–47)

A108. 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 or engagement-level reviews that are undertaken during the course of the engagement on specific aspects of completed work. 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. Paragraphs 40–41 of Appendix 1 provide examples of monitoring activities and how the nature, scope and frequency of the monitoring activities may vary. Paragraph 42 of Appendix 1 explains how the objectivity of those performing the monitoring activities may vary depending on the activity subject to monitoring.

A109. While performing monitoring activities, the firm may determine that changes to the nature, timing and extent of the monitoring activities are needed. For example, the firm may identify findings that indicate the need for more extensive monitoring activities in a particular area.

A110. 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. In such cases, the response is not typically a monitoring activity, because 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). Since the activity is designed as a response to a quality risk, the firm implements monitoring activities to evaluate the design, implementation and operation of the response. However, the nature, scope and frequency of the firm's monitoring activities may be affected by the nature of the response. For example, the firm may require engagement teams to obtain a review of the audited financial statements or other aspects of

completed work by a central technical team prior to dating the audit report (e.g., a pre-issuance review), in order to identify deviations in the engagement that are required to be corrected before issuing the audit report. In this circumstance, the extent of the pre-issuance review may affect the scope or frequency of inspections of completed engagements.

A111. 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. There may be classes of engagements where it is more likely that the quality risks to which the response relates may occur or where there is a greater likelihood of the quality objective not being met, for example, engagements that relate to a particular industry or type of service. 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.

A112. The firm's system of quality management may change as a result of, for example:

- 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 (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 that has elapsed 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 affect the firm's system of quality management, as well as when such monitoring activities were performed.

A113. The findings from the firm's previous monitoring activities, results of external inspections or other relevant information may 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. Furthermore, the monitoring activities may need to evaluate the effectiveness of remedial actions implemented to address deficiencies previously identified.

- That deficiencies existed in previous monitoring activities undertaken by the firm. This may affect the firm's consideration of whether the current monitoring activities planned to be undertaken, or that are being undertaken, are appropriate

The results of external inspections cannot be used by the firm as a substitute for undertaking internal monitoring activities because the manner in which the external inspections are conducted (i.e., the nature, timing and extent of the inspection procedures) may not have been designed with the objective of evaluating the design, implementation and operation of the responses.

A113a. Examples of sources of other relevant information may include:

- Information communicated by the network in accordance with paragraph 61 of this ISQC in relation to the firm's system of quality management, including the network services that the firm uses.
- Information communicated by a service provider about the services the firm uses in relation to its system of quality management.
- Concerns in relation to the commitment to quality of the firm or its personnel, communicated in accordance with paragraph 29(e) of this ISQC.
- A material restatement of financial statements or an engagement report that required reissuance.

Engagement Inspections (Ref: Para. 46)

A114. The factors the firm may consider in establishing criteria for the selection of completed engagements for inspection include:

- Engagements when the firm or engagement partner are inexperienced, for example, a new industry, a new service offering or new engagement partner.
- Engagements performed in respect of certain entities (e.g., a listed entity or entity that has a significant public interest).
- Engagements that have been subject to external inspection and which have negative findings, or engagements where the findings of previous monitoring activities identified deficiencies.
- Engagements where there has been a material restatement of comparative information in the financial statements or the firm's report required reissuance.
- Engagements where the firm's engagement acceptance and continuance procedures indicated that matters may exist that may increase the engagement risk.

A115. The frequency of selection of individual engagement partners depends on many factors, including those described in paragraph A114. The firm may establish different cyclical periods for engagement partners based on the nature of the engagements they perform, for example, the firm may determine that the cyclical period for an engagement partner performing audits of financial statements may be three years.

A116. The selection of completed engagements, together with other monitoring activities, need to be sufficient to support the firm's evaluation of the design, implementation and operation of the system of quality management. Factors that may affect the firm's consideration of the nature and extent of selection of completed engagements for inspection include:

- The extent to which the other monitoring activities involve engagement-level reviews.
- The varying nature of the engagements performed by the firm.
- 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 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 inspections of completed engagements.

A117. 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.

Identifying Deficiencies (Ref: Para. 47–49)

A118. Findings represent the information accumulated from the performance of monitoring activities and may also include the results of external inspections and other relevant information about the firm's system of quality management. Findings may be positive or negative in nature:

- Positive findings may be useful to the firm as they may indicate practices that the firm can support or apply more extensively, for example, across all engagements. They may also highlight opportunities for the firm to improve, or further enhance, the system of quality management.
- Negative findings are considered by the firm in accordance with paragraphs 47–49 in order to determine whether there are deficiencies in the system of quality management.

A119. A deficiency in the system of quality management exists in circumstances when the firm identifies:

- A deficiency in the design of a response, i.e., a response is not properly designed to address a related quality risk or a response necessary to address the quality risk is absent. Such a deficiency is also a deficiency in the firm's quality risk assessment process because it is an indication that a quality objective has not been established appropriately, a quality risk in relation to a quality objective has not been identified or the design of the response is inadequate to address a quality risk.
- A deficiency in the implementation of a response.
- A deficiency in the operation of a response, i.e., it does not operate as designed.

In some circumstances, it may not be possible to identify that a response is absent through considering the findings from the firm's monitoring activities because the firm's monitoring activities

focus on evaluating the design, implementation and operation of responses (i.e., the responses that are in place). Nevertheless, in fulfilling the requirement in paragraph 57, the individual(s) assigned ultimate responsibility for the system of quality management ordinarily considers whether the quality objectives are met, and in doing so may identify that a response is absent.

A120. A finding may affect multiple components, and the firm may determine that a finding is indicative of a deficiency across more than one component. However, not all negative findings are a deficiency in the system of quality management. For example, a finding may be isolated, such that the response is appropriately designed, implemented and operated.

A121. The findings arising from the monitoring activities, results of external inspections or other relevant information may provide information regarding opportunities for the firm to improve, or further enhance, the system of quality management. Furthermore, as part of evaluating the findings arising from the monitoring activities, results of external inspections or other relevant information, and investigating 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 and why they are effectively designed, implemented and operated. For example, in performing inspections of completed engagements, the firm may identify engagements with very few, if any findings and it may be useful to understand the circumstances surrounding such engagements.

A122. The monitoring and remediation process, in conjunction with the other components of the system of quality management, support the firm in achieving the objective of this ISQC. Accordingly, it is necessary that the monitoring and remediation process is evaluated to establish that it is functioning in a manner that achieves its purpose. However, this is undertaken through considering the findings arising from the monitoring activities performed in relation to the responses and the results of external inspections and any other relevant information, i.e., specific monitoring activities are not usually designed to evaluate the monitoring and remediation process itself. Other information sources may indicate deficiencies in the system of quality management that have not been identified by the firm's monitoring and remediation process (e.g., external inspection findings, network inspections or complaints and allegations). In such cases, the firm may consider the nature of the deficiencies identified and the manner in which they were discovered in evaluating the design, implementation and operation of the firm's responses in relation to monitoring and remediation, and consideration of whether there is a deficiency in the firm's monitoring and remediation process.

Root Cause Analysis and Evaluating the Deficiencies (Ref: Para. 50)

A123. 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.

A124. 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 possible severity of the deficiency is not significant and therefore the firm may not undertake a complex process to understand the root cause(s).

Paragraphs 43–44 of Appendix 1 provide examples of the firm's process for investigating the root cause(s) of a deficiency and how the firm may consider findings from its monitoring activities, results of external inspections or other relevant information that are not considered deficiencies.

A125. 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 risk assessment 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. Paragraph 45 of Appendix 1 provides examples of root causes.

A126. 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.

A127. The appropriate remedial action for a deficiency may depend on or be affected by whether the root cause(s) indicates a deficiency in the design, implementation or operation of a response. For example, a deficiency in the design of a response is an indication of a deficiency in the firm's quality risk assessment process and accordingly, the firm may need to implement remedial actions with respect to this process.

Responding Appropriately to the Results of Internal Monitoring Activities, External Inspections and Other Relevant Information

Deficiencies in Relation to Engagements (Ref: Para. 51)

A128. In circumstances when the report issued is inappropriate or procedures were omitted, the further action taken by the firm to comply with relevant professional standards and applicable legal and regulatory requirements may include:

- Discussing the matter with management of the entity or those charged with governance.
- Taking steps to ensure that users of the firm's report are informed of the situation.
- Performing the omitted procedures and amending the report, as appropriate.
- Obtaining legal advice.

The actions taken to correct the work performed or the report issued for a specific engagement does not relieve the firm of the responsibility to investigate the root cause(s) of the deficiency related to the engagement.

Designing and Implementing Remedial Actions (Ref: Para. 52–53)

A129. 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 actions that address how the firm obtains and allocates its human resources or withdrawing from engagements such that sufficient resources are available to perform all of the firm's engagements. The nature, timing and extent of remedial actions may depend on a variety of other factors, including:

- The extent 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 and pervasiveness of the 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.

Ongoing Communication Related to the Monitoring and Remediation (Ref: Para. 54–56)

A132. Frequent and timely communication with the individual(s) assigned ultimate responsibility and accountability and the individual(s) assigned operational responsibility for the system of quality management, as and when matters arise, supports the accountability of these individual(s), and enables them to take prompt and appropriate action, when necessary, in response to such information.

A133. Firm personnel refers to the partners and staff within the firm, which includes engagement teams, professionals and any experts the firm employs.

A134. In determining the information to be communicated to firm personnel, 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. Communicating remedial actions may support the implementation of such actions in a more proactive manner.

A135. Paragraph 29(d) includes requirements regarding the communication of information in relation to the firm's system of quality management to firm personnel at least annually, which may include the communications required by this section. However, the firm still has a responsibility to communicate information in relation to the firm's monitoring and remediation process on a timely basis to firm personnel, to the extent that it is relevant to their responsibilities and is necessary to enable them to take prompt and appropriate action in accordance with their responsibilities.

Evaluating the Effectiveness of the System of Quality Management (Ref: Para. 57–58)

A137. The individual(s) assigned ultimate responsibility and accountability for the system of quality management uses the information obtained in accordance with paragraph 54 in evaluating the effectiveness of the system of quality management. However, it may be necessary to obtain additional information. The evaluation of whether the system of quality management provides the firm with reasonable assurance in accordance with paragraph 15 includes consideration of the severity and pervasiveness of the deficiencies, individually and in combination with other deficiencies.

A138. In circumstances when the firm's evaluation in paragraph 57 indicates that the firm has not achieved reasonable assurance in accordance with paragraph 15, in addition to the communication required by this ISQC, the firm may consider other actions such as:

- Obtaining legal advice.
- Taking steps to determine whether the reports already issued by the firm were appropriate.
- Determining appropriate measures to ensure that reports not yet issued by the firm are appropriate in the circumstances.

A138a. Circumstances when it may be appropriate for the firm to communicate to external parties that the firm has not achieved reasonable assurance in accordance with paragraph 15 include:

- (a) When the firm is required by law or regulation to communicate this fact.
- (b) When the firm belongs to a network and the information is relevant to the network or other firms within the network who use the work performed by the firm, for example, in the case of a group audit.
- (c) When a report issued by the firm is determined to be inappropriate as a result of the failure of the system of quality management, and management or those charged with governance of the entity need to be informed.

Considerations in Relation to Networks (Ref: Para. 59–63)

A139. Ordinarily networks establish contractual terms that set out the responsibilities of the network and the network firms, and may further establish how the network firms and the network interact and the nature of relationships and interaction with other network firms. The contractual terms may state the network services that the firms are required to use. The network may also provide services that the firm is able to choose to use.

A140. The firm obtains an understanding of the network services in order to establish whether they may be used in relation to the firm's system of quality management. For example, the network may establish common quality objectives and quality risks for all of the network firms, and the firm may therefore determine whether the quality objectives and quality risks are relevant to the nature and

circumstances of the firm, the engagements performed by the firm and the types of entities for whom the engagements are undertaken. Although the network may establish such quality objectives and quality risks, this does not relieve the firm of its responsibility to address the requirements related to the quality risk assessment process in paragraphs 24–26.

A141. 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 will be adequate to support the firm in determining how the network services affect the firm's system of quality management. 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.

A142. The procedures undertaken by the firm to understand the network's process(es) may vary based on the nature of the service. Such procedures may include obtaining and reading the network's description of its processes in relation to the network services, including understanding:

- The procedures, within both information technology and manual systems, by which the network services are provided.
- The related records and supporting information that are used within the network's process.
- How the network responds to changes in circumstances or other information that affects the network services;
- The process used to prepare and provide information to the firms within the network;
- The firm's responsibilities and supplementary actions contemplated in the design of the network service.
- The network's governance and leadership.
- How the network has identified the quality objectives, quality risks and responses relevant to the service, to the extent that it is relevant to the network services provided.
- How the network monitors the network services and its processes for evaluating the findings from monitoring activities and remediating deficiencies.

A143. The understanding of the network's service(s) may indicate that such services are not designed, implemented or operated such that they can be used by the firm in its system of quality management. In such cases, the firm may:

- Agree with the network how the circumstance may be remediated such that it is appropriate to use the network services in the firm's system of quality management;
- 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.

In some cases, although the firm may be satisfied with the design, implementation or operation of the network service, the firm may need to supplement the network services. For example, the network may establish common quality objectives, quality risks and responses across the network, however the firm may need to supplement them to address jurisdictional matters.

A144. For many services, the firm may 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 A90–A93 set out further considerations in relation to the use of technological resources and intellectual resources obtained from a network). 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. 61–63)

A145. Paragraph 44 requires the firm to evaluate the system of quality management, which includes the network services used by the firm. The services may be monitored by the network, the firm, or a combination of both. 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. When the monitoring is undertaken by the network, it forms part of the firm's monitoring activities and the firm obtains the findings from such monitoring activities. This may also include information, such as:

- A description of the monitoring procedures performed, including the scope, nature and frequency of such monitoring activities.
- The network's evaluation of whether the findings indicate a deficiency, the root cause(s) of the deficiency, the assessed effect of the deficiency and remedial actions.

A146. The network may also 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 600.¹⁸ 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.

A147. 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, 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.

¹⁸ ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

Considerations Relating to Use of Service Providers (Ref: Para. 64–65)

- A148. The service providers used by the firm may include individuals or organizations. Examples of services provided by service providers include providing a methodology or audit software, performing engagement quality control reviews or providing technical resources to support consultation.
- A149. The firm's responsibilities in using the service provider may include matters such as the actions the firm needs to take in order to implement the service in the firm or information the firm needs to communicate to the service provider in order that the service can function effectively. For example, in the case of software provided by a service provider, the firm may need to have the appropriate technological infrastructure in place to support the software and provide training to firm personnel (paragraphs A90–A93 set out further considerations in relation to the use of technological resources and intellectual resources obtained from a service provider).
- A150. Obtaining an understanding of the service provider may include understanding the conditions of the service, for example, how often updates will be provided in relation to the service, limitations on the use of the service and how the service provider addresses confidentiality of data and information. Understanding the expected form, timing and content of communications between the firm and the service provider is necessary in determining how the firm will be alerted to matters affecting the use of the service, for example, updates to software or methodologies, or deficiencies in the services.
- A151. The appropriateness of the technical competence, professional skills and professional values, ethics and attitudes of the service provider will vary depending on the nature of the underlying services. For example, *[placeholder to reference to ISQC 2 and the criteria for the eligibility of an individual to be able to perform an engagement quality control review]*. The reputation of the service provider may also provide an indication of whether their technical competence, professional skills and professional values, ethics and attitudes are appropriate in the circumstances. In some cases, depending on the nature of the service being provided, the service provider may need to comply with the relevant ethical requirements applicable to the firm, for example, in the case of an engagement quality control reviewer, technical resources who provide consultation, external experts and when the firm uses individuals to perform procedures at an engagement level.
- A152. The procedures undertaken by the firm to understand the service provider's processes may include obtaining and reading the service provider's description of its processes in relation to the services, including understanding the matters described in paragraph A142. Furthermore, understanding how the service will be evaluated and remediated is necessary in determining whether the firm will have the information it needs to be able to evaluate its system of quality management. In some circumstances, the service may not be evaluated and remediated by the service provider and the firm may instead perform monitoring activities over the service, for example, in the case of an engagement quality control review undertaken by a service provider. There may be circumstances when the service provider supplies the firm with an assurance report on the description and design of their controls, and in some circumstances, it may also include assurance on the operating effectiveness of such controls.

Documentation (Ref: Para. 66–69)

- A153. 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 documented confirmation from firm personnel regarding compliance with the firm's policies or procedures in relation to independence.

A154. 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 have changed 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 66. 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, because informal communication methods may be effective in supporting a consistent understanding of the firm's system of quality management and consistent implementation and operation of the responses. Nevertheless, in some cases, the firm may determine it appropriate to document such communications in order to provide evidence of the design, implementation and operation of the responses. Digital information held in 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 findings from monitoring). Manual methods of recording information, such as notes, checklists and forms, may also be appropriate.

A155. 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. Relevant ethical requirements may also include specific requirements addressing documentation, for example, the IESBA Code requires documentation of particular matters in relation to conflicts of interest,¹⁹ non-compliance with laws and regulations²⁰ and independence.²¹

A156. 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. Paragraph 46 of Appendix 1 illustrates how the firm's governance and leadership may be documented.

¹⁹ See, for example, paragraphs R310.13 of the IESBA Code.

²⁰ See, for example, paragraphs R360.28 of the IESBA Code.

²¹ See, for example, paragraphs R400.60, R400.88, R400.89, R900.40, R900.44 and R900.45 of the IESBA Code.

Appendix 1

Examples Supporting the Application of ISQC 1

The Firm's System of Quality Management (Ref: Para. A3)

1. Quality management is a continual, dynamic process that involves an ongoing consideration of whether the firm's system of quality management is designed, implemented and operated to provide the firm with reasonable assurance in accordance with paragraph 15. A system of quality management is designed according to the nature and circumstances of the firm, the engagements performed by the firm and the types of entities for whom the engagements are undertaken, through applying the quality risk assessment process. The system of quality management is updated when there are changes in the circumstances of the firm, the engagements it performs and the types of entities for whom such engagements are performed or when deficiencies in the system are identified. The firm may also update the system of quality management in response to other information, for example, new technology may become available that is more effective in addressing quality risks and achieving the quality objectives.
2. The eight components in this ISQC have similarities to the components of internal control described in ISA 315 (Revised). For example, the governance and leadership is similar to the entity's control environment and the quality risk assessment process is similar to the entity's risk assessment process.

Applying, and Complying with, Relevant Requirements (Ref: Para. A15)

4. In the circumstances of a sole practitioner with no staff, examples of the requirements of this ISQC that may not be relevant include:
 - 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 matters related to independence or operational responsibility for the monitoring and remediation process.
 - Undertaking periodic performance evaluations that assess the effectiveness of firm leadership.

Governance and Leadership

Culture (Ref: Para. A21)

5. The actions undertaken by the individual(s) assigned ultimate responsibility and accountability for the system of quality management to foster a culture of quality throughout the firm 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 a culture that focuses on professional values, ethics and attitudes and the performance of quality engagements.
6. In circumstances when the firm belongs to a network, the culture of the firm may be influenced and supported by the network, for example through:
- The tone of leadership at the network level and the emphasis placed on the importance of quality.
 - The network holding the firm leadership accountable for quality.
 - The requirements imposed by the network on firms within the network in order to be able to belong to the network, including the policies or procedures with which the firm is required to establish and comply.
 - How the network manages and responds to matters in relation to quality across all of the firms within the network, including the timeliness of the responses, communication of quality matters and what actions are taken in relation to firms that do not comply with network requirements.

Organization of the Firm and Resources (Ref: Para. A27)

7. In some jurisdictions, law or regulation may mandate the appointment of a governing body comprising a minimum number of independent non-executive members and it may further prescribe the function or responsibilities of those appointed within these roles. In establishing the leadership structure of the firm, it may be appropriate in some circumstances to appoint Individual(s) who are independent from the ownership of the firm (i.e., who do not hold a financial interest in the firm) and who are not involved in the daily operations, as they may be able to provide impartial judgment in the firm's decision-making, that takes into consideration the legitimate interests of relevant stakeholders.

Quality Risk Assessment Process

Establish Quality Objectives (Ref: Para. A39)

8. 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. For example:
- The firm may organize its divisions or operating units according to the nature of the engagements performed by the firm and the quality objectives may be established according to the specific engagements performed by the operating units.
 - The firm may organize its divisions or operating units according to the industries of the entities for whom the firm provides services and the quality objectives may be tailored to the specific industry, for example, financial institutions.

Identify and Assess Quality Risks (Ref: Para. A42)

9. In assessing the effect of a quality risk on the achievement of a quality objective, the firm may consider the rate at which the effect of a quality risk would take place, or the amount of time that the firm has to respond to a quality risk. For example:
- Due to the implementation period typically provided after the issuance of new or revised standards, the firm may be able to sufficiently communicate the changes to personnel and train them as necessary as well as perform any updates in its system of quality management during this implementation period and in advance of the effective date, thereby lowering the risk of non-compliance with the standards when they are effective.
 - The firm may identify a quality risk that the firm does not have personnel that have appropriate technical competence, professional skills and professional values, ethics and attitude to perform engagements as a result of high staff turnover. In such cases, the firm is often not able to foresee when it will experience high staff turnover and therefore the rate at which the effect would take place is immediate. This may increase the firm's assessment of the effect of the quality risk on the achievement of the quality objective.
10. The firm may also consider the duration of time of the effect of the quality risk after it has occurred in assessing the effect of a quality risk on the achievement of a quality objective. For example:
- The risk of non-compliance with new or revised relevant ethical requirements may be higher in the short-term (i.e., in the period immediately following its effective date). The risk may decrease in the longer term as firm personnel become knowledgeable about and accustomed to the changes in requirements.
 - In the case of the high staff turnover described above, if the firm expects that they will be able to replace the personnel in a relatively short period of time with personnel that have appropriate technical competence, professional skills and professional values, ethics and attitude to perform engagements, the effect of the quality risk on the achievement on the quality objective may be reduced.

Design and Implement Responses to Quality Risks (Ref: Para. A45)

11. 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.
- 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 pre-issuance review, the firm may factor the results of the pre-issuance review into performance evaluations.

Information and Communication (Ref: Para. A50–A51)

12. Examples of the information that is relevant in supporting the functioning of the components include:
- Quality risk assessment 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 the 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.
13. Firm personnel's responsibilities for communication may include, for example, communicating information to an individual within the firm about identified threats to compliance with the firm's independence policies or procedures or communicating breaches of the independence requirements to the individual(s) assigned operational responsibility for independence.
14. Information relating to the firm's system of quality management that the firm may communicate to engagement teams, in addition to the information that is required to be communicated in relation to monitoring and remediation, 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 engagement personnel.
 - 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.
15. Information relating to the firm's system of quality management that may be communicated to personnel performing duties in relation to the operation of the firm's system of quality management, in addition to the information that is required to be communicated in relation to monitoring and remediation, include:
- Information that describes the authority, roles and responsibilities of such personnel.
 - Information that supports the oversight of the firm's system of quality management by the individual(s) who is ultimately responsible and accountable for the system of quality management, 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 network services.
 - 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 threats to compliance with the firm's independence

requirements, information communicated by an engagement team regarding non-audit services provided to an entity or information communicated by engagement quality control reviewers.

16. Information that is obtained from or communicated to parties that are external to the firm may include the following:
- Information about the network services
 - 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 in order that they can comply with such policies or procedures (e.g., related to matters such as the firm's independence requirements or confidentiality of information).

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

17. 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.

Considerations in Relation to Networks

18. The network may establish information systems that obtain, generate or communicate information, for example, the network may establish an information system that records and maintains information in relation to independence. In such a circumstance, the network ordinarily establishes policies or procedures on the information that is required to be provided by the firms within the network and their personnel, and the network would communicate relevant information to the firms within the network such that the firm is able to identify threats to compliance with its independence requirements or breaches of the independence requirements.

19. 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:
- A complaint in relation to the network may arise in relation to an error in the methodology developed by the network.
 - A complaint in relation to another network firm may arise in the case of a group audit, i.e., the work performed by another network firm on a component within the group

Acceptance and Continuance of Client Relationships and Specific Engagements

Integrity and Ethical Values of the Client, including Management, and, When Appropriate, Those Charged with Governance (Ref: Para. A72–A73)

20. Information regarding the integrity and ethical values of the client may include 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 a 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.
21. Other sources of information may include:
- Discussions with other third parties, such as bankers, legal counsel and industry peers.
 - Inquiry of other firm personnel.
 - Background searches of relevant databases.

The Firm's Ability to Perform the Engagement (Ref: Para. A77)

22. 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:
- The firm has sufficient personnel to undertake the engagement, including personnel to direct and supervise the engagement and take overall responsibility.
 - Firm personnel assigned to the engagement have appropriate technical competence, professional skills and professional values, ethics and attitudes to perform engagements, or the ability to gain these effectively. This includes 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.

- 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. The firm has appropriate technological resources to support the performance of the engagement, for example, engagement software or applications that enable the engagement team to perform procedures on the entity's data.
- The firm has appropriate intellectual resources to support the performance of the engagement, for example, a methodology, industry or subject matter-specific guides, or access to information sources.

Resources (Ref: Para. A85–A86)

23. The IESs issued by the IAESB 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.
24. 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, which allocate firm personnel, taking into consideration the quality risks associated with particular engagements and the firm's available staff resources. 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.
25. 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;
- Understanding of the firm's system of quality management; and
- Organization skills, in particular the organization and management of the engagement such that it is undertaken in an efficient manner and within the required timeframe.

Technological Resources (Ref: Para. A90–A91)

26. 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. The firm may develop technology internally, acquire technology from a third party service provider, or the firm's network may provide technology. The firm's technology support may also be internal or a service provider may be used to provide technology support. Service providers may also be used for the purposes of data storage.
27. 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 nature and circumstances of the firm, the engagements performed by the firm and the types of entities for whom the engagements are undertaken. 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.
28. In circumstances when the firm acquires a technology from a service 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.
 - Inquiring 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.

29. 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.
 - Support resources (e.g., help desks, how-to guides) for those who use the technology as well as appropriate personnel to perform in-house maintenance of the technology as necessary (e.g., program changes, infrastructure changes).
30. 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 confidentiality of the data and to ensure that software and applications used by the firm, including in performing engagements, are protected from unauthorized changes. Unauthorized changes to software and applications could result in such software or application operating inappropriately, for example:
- Unauthorized changes to the firm's valuation software could provide outcomes or results that are inaccurate, which could affect the firm's judgments and conclusions in relation to the engagement.
 - Unauthorized changes to the firm's engagement software could result in engagement teams not performing the engagement in accordance with professional standards.
31. 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 or, service providers. 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.

Intellectual Resources (Ref: Para. A93)

32. 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 supports the performance of the audit in accordance with professional standards, whereas firms that only perform compilation engagements or agreed upon procedures may not need such methodologies, but may develop other forms of guidance for these engagements. Furthermore, a firm performing audits of financial statements of particular types of entities may

also develop specific guidance in relation to those entity types, for example, audits of banks and other financial institutions.

- Firms that perform engagements of entities that have a wider public interest may subscribe to information sources that provide information about such entities, including related entities, their management and those charged with governance, which may be useful in supporting the firm's decision about engagement acceptance and continuance.
33. 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.
 - Establishing how the intellectual resources will be made available to the firm.

Engagement Performance

Consultation (Ref: Para. A98)

34. 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.
35. 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.

Engagement Documentation

Completion of the Assembly of Final Engagement Files (Ref: Para. A101)

36. 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, i.e., the time limits for the

assembly of final engagement files address each report as if it were for a separate engagement. 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 (Ref: Para. A103)

37. 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.
38. 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 passwords 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 (Ref: Para. A104)

39. 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 as 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.

Monitoring and Remediation Process

Designing and Performing Activities to Monitor the Design, Implementation and Operation of the Responses (Ref: Para. A108)

40. 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.
41. 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.
42. 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.

Root Cause Analysis and Evaluating the Effect of Deficiencies (Ref: Para. A124–A125)

43. In some 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.
44. 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 findings identified by the firm through its monitoring activities, external inspections or other relevant 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 finding is pervasive or systemic.
45. 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 as the firm has not established an effective process for risk identification, 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).

Documentation (Ref: Para. A156)

46. 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.