

### Quality Management (Firm level) – Proposed ISQC 1 (Revised)<sup>1</sup>: Issues

#### Objective of the IAASB discussion

The objective of this Agenda Item is to obtain the IAASB's input on the draft Exposure Draft (ED) of Proposed ISQC 1 (Revised), set out in **Agenda Item 7–A**. This paper provides an overview of the Quality Control Task Force's (QCTF) considerations in developing the draft ED.

#### Introduction

1. This paper should be read in conjunction with **Agenda Item 7–A**, the clean version of draft proposed ISQC 1, which will be used for the discussion with the IAASB. **Agenda Item 7–B** includes the proposed ED of ISQC 1 (Revised) with changes marked from the version presented to the IAASB in December 2017. References to **Agenda Item 7–A** in this paper also refer to **Agenda Item 7–B**. **Agenda Item 7–C** provides a comparison of the requirements in extant ISQC 1 to **Agenda Item 7–A**.
2. The various sections of this paper include extracts from the minutes of the December 2017 IAASB meeting, to provide the necessary context for the changes to proposed ISQC 1 (Revised). The QCTF notes that many of the changes to the draft of proposed ISQC 1 (Revised) were in response to written comments provided by IAASB members.

#### Applicability of Proposed ISQC 1 (Revised) to a Broad Spectrum of Firms and Length of the Standard

##### *Summary of December 2017 IAASB Discussions*

3. At its December 2017 meeting, the IAASB discussed:
  - (a) Developing accompanying guidance or an appendix to the standard that is issued with the ED, which addresses how the standard would be applied to a broad spectrum of firms of varying complexity and size, including a sole practitioner.
  - (b) Exploring how the scalability of the standard could be further emphasized.
  - (c) Including more emphasis on the nature and circumstances of the engagements performed by the firm throughout the standard, i.e., in addition to the nature and circumstances of the firm.

##### *Task Force Views*

##### Examples and Accompanying Guidance

4. At the December 2017 meeting, the proposed ED of ISQC 1 (Revised) included various application material that was marked in "grey text". This application material comprised mostly of examples of how the standard may be applied, with some examples of how it applies to varying sizes of firms. The QCTF has yet to further develop the guidance that demonstrates how the standard may be

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

applied to a broad spectrum of firms, i.e., additional examples that demonstrate how the requirements relating to each component of proposed ISQC 1 (Revised) apply to different sizes or complexity of firms. The QCTF recognizes that these kinds of examples would not be suitable in the standard, and would be best located outside of the standard, for example, in the explanatory memorandum that would accompany the ED, and ultimately in a separate guide or publication for use by practitioners when the standard is finalized.

5. The application material marked in “grey text” in the December 2017 draft has been relocated to the appendix of the proposed ED of ISQC 1 (Revised). The QCTF recognizes that some of the application material in proposed ISQC 1 (Revised) needs to be considered in terms of whether it should remain as application material, or be moved into the appendix. However, the QCTF is uncertain as to whether the appendix is the appropriate location for the additional material, or whether the material should also be included in a separate publication. The challenges that the QCTF has identified in relation to locating the material in the appendix versus a separate publication include:

Locating material in the appendix	Locating material in a separate publication
<ul style="list-style-type: none"> <li>• The material adds length to a standard that is already unwieldy.</li> <li>• Material in the appendix has the same status of authority as application material. Outreach participants, in particular small-and-medium sized practitioners (SMPs), noted that there are circumstances when regulators interpret application material more stringently, i.e., they are viewed as requirements. Therefore the examples in the appendix could inadvertently drive firms to have to implement the examples, thereby reducing the scalability of the standard.</li> </ul>	<ul style="list-style-type: none"> <li>• Users of the standard may not be aware that a separate publication exists, and therefore may inadvertently overlook the publication when applying the standard.</li> <li>• In order to understand the material, it needs the context of the explanations in the application material, i.e., on its own it does not make sense.</li> </ul>

Further Emphasizing the Scalability of the Standard

6. In order to emphasize the scalability of the standard, the QCTF has highlighted the need to apply professional judgment in relation to the system of quality management, and various aspects of the application material specifically mention which decisions may be subject to professional judgment (see paragraphs 6, A4, A39, A40, A43, A107 of **Agenda Item 7–A**). The QCTF is of the view that this highlights the need for firms to consider their circumstances in designing a system of quality management that is appropriate to their circumstances.

### **Matters for IAASB Consideration**

1. The IAASB is asked to share their views regarding:
  - (a) The appropriate location of the guidance that is currently included in Appendix 1 of proposed ISQC 1 (Revised), i.e., whether this should remain in the Appendix or be located elsewhere.
  - (b) The development of further guidance that demonstrates the application of the standard to different sizes or complexities of firms, which would be located in the explanatory memorandum accompanying the ED.
  - (c) The emphasis on the application of professional judgment throughout the standard.

### **Introduction of Proposed ISQC 1 (Revised)**

7. Recognizing the IAASB's views to simplify the introductory section, the QCTF has removed most of the material that explained the system of quality management. Some of this material has been relocated to the appendix and further enhanced and clarified.
8. Additional paragraphs have been added addressing the firm's responsibility to act in the public interest, which is further explained in paragraph 53 below. Furthermore, in order to emphasize the scalability of the standard, the introduction emphasizes the need to apply professional judgment, as explained in paragraph 6 above.

### **Objective of the Standard**

#### *Summary of December 2017 IAASB Discussions*

9. At its December 2017 meeting, the IAASB:
  - (a) Sought clarification of the objective of the standard and suggested including a more explicit reference to the components of the system of quality management.
  - (b) Indicated confusion between the objective of the system of quality management and the objective of the standard.
  - (c) Sought clarity in relation to the multiple layers of objectives throughout the standard, given the proposal to have component objectives and quality objectives, and suggested rearticulating the component objectives as objectives instead of requirements.

#### *Task Force Views*

10. The QCTF deliberated the objective of the standard extensively. In doing so, the QCTF considered the following:
  - (a) The objective of the firm and how this is different from, or similar to, the objective of the system of quality management.
  - (b) The level at which reasonable assurance exists.
11. The QCTF agreed that ultimately the firm's objective is 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

- (b) Reports issued in relation to engagements by the firm or engagement partners are appropriate in the circumstances.
12. In considering the differences or similarities between the objective of firm and the objective of the system of quality management the QCTF debated the level at which reasonable assurance exists. For example, whether:
- (a) The system of quality management provides the firm with reasonable assurance about the achievement of the firm's objective.
- (b) The firm obtains reasonable assurance that the system is designed, implemented and operating effectively.
- (c) The firm obtains reasonable assurance that the system achieves its objective.
13. The QCTF agreed that:
- (a) Similar to the COSO Internal Control – Integrated Framework,<sup>2</sup> a system of quality management cannot be designed to give 100% assurance regarding the achievement of the firm's objective, because of the inherent limitations of a system (e.g., human error, uncertainty in judgment, the impact of events etc.). Accordingly, the objective of the system of quality management is to provide the firm with reasonable assurance regarding the achievement of the firm's objective described in paragraph 11.
- (b) The provision of reasonable assurance is built in to the system, i.e., it is provided through the various responses within each component that operate together.
- (c) The objective of the firm in the context of the standard is to design, implement and operate a system of quality management. If the objective of the firm were to obtain reasonable assurance that the system is designed, implemented and operating effectively, or that the system achieves its objective, the firm would need to do so through conducting an assurance engagement over the system of quality management, for example, an assurance engagement similar to a type 2 report issued in accordance with ISAE 3402.<sup>3</sup> The QCTF is of the view that this is not appropriate, as this is not the overall intention of the standard.
14. Given the clarity regarding the objective of the system of quality management and the objective of the firm, the QCTF agreed that the objective of the system of quality management is an essential aspect of the objective of the firm in paragraph 15 of **Agenda Item 7–A**.
15. The QCTF further explored consolidating the various component objectives into the objective of the standard, or more explicitly referring to the components, such that it would provide a description of the system of quality management. However, in attempting this, it resulted in an overly complex objective. Furthermore, the QCTF is of the view that the establishment of the components is not the objective of the system; the components are the means through which the system achieves its objective. As a result, the QCTF has instead:

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<sup>2</sup> Committee of Sponsoring Organizations of the Treadway Commission (COSO), *Internal Control – Integrated Framework*. In terms of the COSO Integrated Framework, the system of internal control provides management and the board of directors with reasonable assurance regarding the achievement of the entity's objectives.

<sup>3</sup> International Standard on Assurance Engagements (ISAE) 3402, *Assurance Reports on Controls at a Service Organization*

- (a) Proposed a new definition for the system of quality management, which sets out the eight components that form part of the system of quality management. This also:
  - (i) Creates consistency with the definition of a system of internal control in proposed ISA 315 (Revised).<sup>4</sup>
  - (ii) Makes it clear that all eight components need to be in place when designing, implementing and operating a system of quality management.
- (b) Included a description of the components in paragraph 19 of **Agenda Item 7–A**, which is the requirement to establish the system of quality management.

#### Multiple Layers of Objectives

16. The QCTF recognized the concerns of the board regarding the complexity that arose through the multi-layer objectives. The QCTF has removed the component objectives out of each component, however the descriptions of the components have been retained, refined and included in:
- (a) Paragraph 19 of **Agenda Item 7–A**, which is the overarching requirement to establish the system of quality management through the requirements in the ISQC. The QCTF is of the view that including the descriptions here emphasizes the need for, and interrelationship of, the components, and describes the robustness of the system of quality management that is required to be implemented to achieve the objective of the standard.
  - (b) The lead-in to the requirement to establish quality objectives in each of the components. The QCTF is of the view that it is needed in order to establish a benchmark for the firm in terms of what the quality objectives need to address.

#### Matters for IAASB Consideration

- 2. The IAASB is asked to share their views regarding the proposed objective of the standard.
- 3. The IAASB is asked to share their views regarding how the components have been referenced and described in proposed ISQC 1 (Revised).

#### Definitions and Other Terms

##### *Summary of December 2017 IAASB Discussions*

17. At its December 2017 meeting, the IAASB:
- (a) Asked the QCTF to consider the use of policies or procedures, taking into account the developments on proposed ISA 315 (Revised) and proposed ISA 220 (Revised).<sup>5</sup>
  - (b) Requested the QCTF to consider the correct use of the terms “sufficient” and “appropriate” throughout the standard.

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<sup>4</sup> International Standard on Auditing (ISA) 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

<sup>5</sup> ISA 220, *Quality Control for an Audit of Financial Statements*

## Task Force Views

### Policies or Procedures

18. In previous proposals to the IAASB, the QCTF had proposed using the term “responses” instead of policies and procedures in order to emphasize that formal policies and procedures are not always required, thereby improving the scalability of the standard. At the time, the QCTF had considered the term “controls”, but concluded that the term responses was more reflective of the management of quality, rather than the control of quality. The QCTF noted the considerations with respect to “controls” and “policies or procedures” under the ISA 315 (Revised) project and agreed that proposed ISQC 1 (Revised) should be consistent, as far as possible, with the principles of ISA 315 (Revised). Accordingly, the QCTF has amended the definition of responses to align with the definition of controls in proposed ISA 315 (Revised), and to reflect the notion that responses are policies or procedures in all instances, however the response does not need to comprise formalized policies or procedures, i.e., it could include aspects of governance (such as tone at the top) and other aspects of the firm’s system which are established, such as information systems (see paragraph 16(w) of **Agenda Item 7–A**).
19. The QCTF considered whether the term “responses” should be switched to policies or procedures, but concluded that the term “responses” is more appropriate, since:
- It helps emphasize that formalized policies or procedures are not required in all instances, as explained above.
  - Retaining language similar to extant ISQC 1 (i.e., policies and procedures), may not signal the significant changes in the standard and have the intended effect of changing firm behavior.

### Other Changes in the Definitions

20. Other changes in the definitions in paragraph 16 of **Agenda Item 7–A** are further discussed in the sections below, in the context of the matters to which the definitions relate.

### Other Terms

21. The QCTF has considered the use of the terms “sufficient” and “appropriate” throughout proposed ISQC 1 (Revised) and retained or removed these terms, as appropriate.

#### **Matters for IAASB Consideration**

4. Does the IAASB support the revised definition of responses and the QCTF’s proposal to retain the term “responses” instead of “controls” or “policies or procedures”?
5. Is the IAASB of the view that the references to “sufficient” and “appropriate” throughout proposed ISQC 1 (Revised) are appropriate?

## **Structure of the Standard and Interrelationship of Components**

### *Summary of December 2017 IAASB Discussions*

22. At its December 2017 meeting, the IAASB:

- (a) Expressed mixed views regarding whether the components could be condensed into fewer components.
- (b) Agreed that the quality management process is applied to the governance and leadership component, however questioned the appropriate placement of the governance and leadership component within the standard, and in relation to the diagram of the system of quality management, given its importance as a whole.
- (c) Suggested clarifying the interrelationship of the eight components. In this regard, the IAASB also asked the QCTF to refine the illustration of the system of quality management to improve the reflection of the relationships between the components, draw analogies to the COSO Integrated Framework and proposed ISA 315 (Revised), and to illustrate the relationship with quality management at the engagement level.

#### *Task Force Views*

- 23. The QCTF remains of the view that the eight components are appropriate because whilst the components are inter-related, they are not similar in nature. Furthermore, the retention of certain components is necessary to retain close correlation with proposed ISA 220 (Revised). The QCTF is also of the view that differentiating between the components at the firm level and engagement level is not practicable, since there are aspects operationalized at both levels in many of the components.
- 24. The QCTF has proposed changing the term “quality management process” to “quality risk assessment process” (quality RAP), given various comments that implied that this term creates confusion. The proposed new term also better reflects the correlation of this component with the “entities’ risk assessment process” in proposed ISA 315 (Revised) and the COSO Integrated Framework.
- 25. The QCTF agrees that governance and leadership is a component that is fundamental to establishing the overall system of quality management. The QCTF also noted the original reason for placing the governance and leadership component after the quality RAP, i.e., because the quality RAP is applied to the governance and leadership component. The QCTF considered separating the component and placing some of the responses as direct requirements earlier in the standard. However, doing so could create complexities in evaluating reasonable assurance, as all of the quality objectives and responses operate together to achieve the intended purpose. The QCTF therefore agreed to move the governance and leadership component ahead of the quality RAP, and to include references to the quality risk assessment process in order to signpost that the quality RAP is applied to this component.
- 26. With respect to the IAASB’s comments regarding the interrelationship of the components:
  - (a) As explained above, paragraph 19 of **Agenda Item 7–A** explains each component in the context of the requirement to design, implement and operate a system of quality management, in order to demonstrate the relationship of the components.
  - (b) Paragraph A16 of **Agenda Item 7–A** explains the interrelationship of the components.
  - (c) The diagram of the system of quality management that illustrates the components and their interrelationship will be further developed following the March 2018 IAASB meeting (i.e., once the Board has discussed the structure of the standard and the relationship of the components).

### **Matters for IAASB Consideration**

6. Does the IAASB support the new term for the quality RAP component?
7. Does the IAASB support the proposed location of the governance and leadership component?
8. Is the IAASB of the view that the interrelationship of the components is clear and appropriately reflected in the standard?

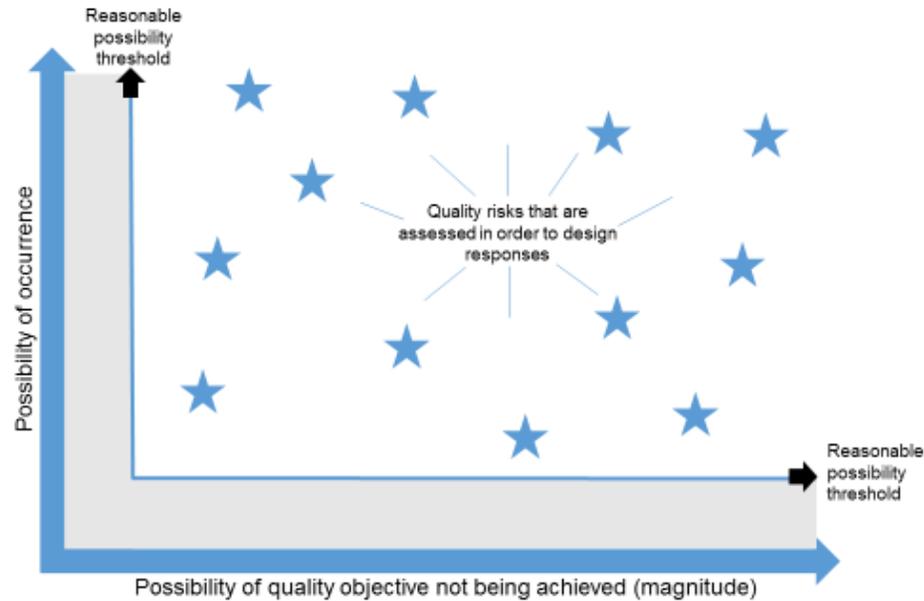
### **Quality Risk Assessment Process (Previously Quality Management Process)**

#### *Summary of December 2017 IAASB Discussions*

27. At its December 2017 meeting, the IAASB:
  - (a) Expressed mixed views regarding whether the quality management process should be a standalone component within the system of quality management.
  - (b) With respect to the identification and assessment of the quality risks, the IAASB suggested the QCTF reconsider the threshold for identifying quality risks, as the proposed threshold would be difficult to apply in practice

#### *Task Force Views*

28. The QCTF observed that during the IAASB discussion, there appeared to be overall confusion between the system of quality management and the quality management process. Accordingly, as discussed in paragraph 24, the QCTF proposes renaming this component to the “quality risk assessment process”, in order to reduce this confusion.
29. The QCTF recognizes that it is impracticable for firms to identify and assess every possible risk that could arise with respect to the achievement of the firm’s quality objectives, and it is therefore necessary to establish an appropriate threshold below which risks do not need to be identified. In its deliberations, the QCTF considered the progress on the ISA 315 (Revised) project in relation to the identification and assessment of risks of material misstatement in an audit of financial statements, including the IAASB’s concurrence to use the threshold of a “reasonable possibility that a misstatement may be material” regarding the threshold for determining relevant assertions. In the view of the QCTF, the “risk of a quality objective not being met” is equivalent to a risk of material misstatement, however in the case of a quality risk, it only comprises inherent risk (control risk is not factored in to the consideration since the purpose of identifying and assessing quality risks is in order to design and implement controls).
30. Considering the approach in proposed ISA 315 (Revised), the QCTF have therefore proposed that the firm:
  - (a) Identifies quality risks. The definition of the quality risks indicates that they are risks that have a reasonable possibility of (i) occurring and (ii) a quality objective(s) not to be achieved.
  - (b) In relation to those quality risks identified, assesses the likelihood of the quality risks occurring and the relative effect of the quality risks on the achievement of the quality objectives. This assessment provides the basis for how the firm responds to the risk.



31. The QCTF is of the view that the above two steps, i.e., the identification and assessment of quality risks, in the context of a system of quality management, may be undertaken simultaneously because the firm is already familiar with the conditions, events, circumstances, actions or inactions that give rise to the quality risks. However, in some circumstances, the firm may need to identify and assess the quality risks more discretely.
32. The QCTF remains of the view that the responses are designed to reduce the quality risks to an acceptably low level, which is a term commonly used across the IAASB's standards, and is a well understood concept.
33. In response to comments raised by the IAASB in December 2017, the QCTF considered the appropriate placement of the requirement in paragraph 26 of **Agenda Item 7–A**, and noted that a similar principle exists in the risk assessment component of the COSO Integrated Framework. The QCTF noted that placing this requirement in the monitoring and remediation component could result in it being confused with changes needed as a result of deficiencies identified in the system of quality management, and that its placement in the quality RAP would better promote a proactive consideration of the quality objectives, quality risks and responses when changes arise.

#### **Matters for IAASB Consideration**

9. The IAASB is asked to share their views regarding the quality RAP, in particular whether the IAASB supports the approach for the identification and assessment of quality risks, including how the threshold has been established.

#### **Monitoring and Remediation**

##### *Summary of December 2017 IAASB Discussions*

34. At its December 2017 meeting, the IAASB suggested:
  - (a) Further developing and clarifying the concepts of a shortcoming, deficiency and major deficiency.

- (b) Developing a framework for the identification and evaluation of deficiencies.
- (c) Clarifying how the monitoring and remediation component relates to the firm's evaluation of whether the overall objective of the standard has been achieved (i.e., that it has reasonable assurance).
- (d) Considering the role of in-process engagement reviews within the context of the firm's ongoing monitoring activities.
- (e) Exploring whether the firm should be required to perform an annual evaluation of the results of the monitoring activities, in addition to responding to the results of the ongoing monitoring activities on a timely basis.
- (f) Clarifying how monitoring and remediation and the concept of a deficiency relates to the quality management process and the monitoring and remediation component itself. In this regard, the IAASB noted the practical difficulty of "monitoring the monitoring" and therefore urged the QCTF to clarify the expectations on the firm.
- (g) Clarifying the implications for the firm in circumstances when the firm determines that a major deficiency exists.
- (h) Improving the emphasis on undertaking a root cause analysis on engagements that went well.
- (i) Further refining the requirements addressing the communication of deficiencies and major deficiencies.

#### *Task Force Views*

##### Definition of Deficiencies and Major Deficiencies

35. The QCTF debated the concepts surrounding a deficiency in the system of quality management, including how these would be identified. In doing so, the QCTF considered the COSO Integrated Framework and how a deficiency in internal control is explained in ISA 265.<sup>6</sup> The QCTF also noted the description of a deficiency in the *Standard for Internal Control in the Federal Government*, issued by the U.S. Government Accountability Office.<sup>7</sup>
36. The QCTF agreed that the definition of deficiencies (see paragraph 16(b) of **Agenda Item 7–A**) should focus on a failure in a response because:
- (a) A failure by the firm to establish a quality objective or identify a quality risk would ultimately be detected through a response, for example, if the firm failed to identify a quality risk, a response would be missing or would be inadequate.
  - (b) When performing monitoring activities, these are performed over the firm's responses, i.e., it is not practicable to monitor quality risks or quality objectives.
37. The QCTF is further of the view that:
- (a) In order to clarify what a deficiency is, it is helpful to explain how a deficiency may arise i.e., through the design, implementation or operation of a response. The root cause analysis would

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<sup>6</sup> ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*

<sup>7</sup> See paragraphs OV3.05, OV3.06, OV3.07 and the definition of deficiency in the glossary of the [Standard for Internal Control in the Federal Government](#)

ordinarily reveal whether the deficiency is in the design, implementation or operation of a response and in circumstances when it is in the design of a response, it may indicate a shortcoming in relation to the quality objective or quality risk.

- (b) The quality RAP and monitoring and remediation process are also responses designed by the firm, and deficiencies apply to these components too. The requirements in proposed ISQC 1 (Revised) addressing the quality RAP and monitoring and remediation represent the prescribed responses applicable to all firms in relation to these components (see paragraph A13 of **Agenda Item 7–A**). Proposed ISQC 1 (Revised) does not specifically require the firm to apply the quality RAP to these components, however firms may voluntarily apply the quality RAP to the monitoring and remediation process, as explained in paragraph A38 of **Agenda Item 7–A**.
  - (c) The quality RAP is monitored through the monitoring of the responses, i.e., a deficiency in the design, implementation or operation of a response may indicate a deficiency in the quality RAP. The monitoring and remediation process is monitored through considering the findings arising from the monitoring activities and the results of external inspections and any other relevant information (see paragraph 49 of **Agenda Item 7–A**).
38. The QCTF debated whether the proposed definition of deficiencies establishes an appropriate threshold above which failures are considered deficiencies. The QCTF noted the importance of an appropriate threshold, since the identification of a deficiency triggers the need for the firm to understand the root cause of the deficiency, remediate the deficiency and possibly communicate it. The QCTF agreed that:
- (a) There is an implicit threshold that has been created in ISQC1 because, responses are designed and implemented to address quality risks *that are more than reasonably possible*, i.e., responses are not designed to address quality risks that are insignificant. Therefore all deficiencies contemplated by the standard address quality risks that already have some level of significance.
  - (b) Extant ISQC 1 has a lower threshold for matters that are considered deficiencies, since the term is used in the context of all findings, irrespective of their significance.
39. The QCTF has proposed removing the concept of a major deficiency given the proposal to eliminate the component objectives, and clarify the objective of the standard. Furthermore, the QCTF recognized the IAASB's confusion regarding the need for this concept and its value to the standard. The consideration of the severity of the deficiencies has instead been incorporated into the framework for the identification and evaluation of deficiencies described below.

Framework for the Identification and Evaluation of Deficiencies (*Refer to the flowchart in Appendix 4, which illustrates the monitoring and remediation process*)

40. The QCTF has enhanced and clarified the framework for the identification and evaluation of deficiencies, including:
- (a) Clarifying that the firm considers the findings from its monitoring activities, the results of external inspections and any other relevant information in identifying deficiencies (see paragraphs 47(b) and 48 of **Agenda Item 7–A**). Findings are described in the application material, which emphasizes that these may be both positive and negative and further notes that not all negative findings are deficiencies.

- (b) Clarifying how the firm identifies deficiencies in the monitoring and remediation process itself. In this regard, the QCTF noted the IAASB's confusion regarding the requirement to "monitor the monitoring process", and therefore has focused this requirement on considering the findings arising from the monitoring activities in general and the results of external inspections and any other relevant information. This is because monitoring activities are not usually designed to evaluate the monitoring and remediation process itself, however other information sources may indicate deficiencies in the firm's monitoring and remediation process (e.g., external inspection findings or network reviews may identify a finding that was not detected by the firm's internal monitoring activities).
  - (c) Introducing a new requirement for the firm to evaluate the effect of the deficiencies on the achievement of the quality objectives, through considering the severity and pervasiveness of the deficiencies (see paragraph 50(c) of **Agenda Item 7–A**). This requirement ultimately supports the firm's considerations regarding (i) the remediation of the deficiency (e.g., more severe deficiencies may indicate the need for a more urgent response), (ii) the extent of communication, and (iii) the annual evaluation of the system of quality management described in paragraph 47 below.
41. The framework still includes the responsibility to investigate the root cause of the deficiencies. The QCTF considered the comments regarding placing emphasis on undertaking a root cause analysis on engagements that went well, but is of the view that:
- (a) Proposed ISQC 1 (Revised) needs to have a clear framework for identifying and assessing deficiencies, and addressing deficiencies in an appropriate and timely manner. Including engagements that went well could blur this framework.
  - (b) It is impracticable to establish a requirement for the firm to consider engagements that went well, as it would require a common understanding across all engagement types of what is considered a "good engagement".
  - (c) Requiring firms to undertake a root cause analysis on engagements that went well imposes a requirement on all firms, and it may not be appropriate in some circumstances (i.e., it presents a scalability issue).

Although the QCTF agreed that there should not be a requirement for firms to perform a root cause analysis on positive findings, the QCTF has amended the definition of "root cause analysis" to recognize that it may be a process applied to all types of findings, both positive and negative.

#### Inspection of Completed Engagements and In-Process Reviews

- 42. The QCTF has proposed various enhancements to the requirement addressing the inspection of completed engagements in order to increase the emphasis on a risk based approach, through considering various factors. This was in response to Board comments that inspections should focus on areas of risk.
- 43. The QCTF also considered the proposal to address in-process engagement reviews within the context of the firm's ongoing monitoring activities, however the QCTF is of the view that in-process engagement reviews (i.e., reviews of incomplete engagement work) are likely to be designed as a response to a quality risk as they are often designed to detect errors and correct them before the engagement report is issued. Paragraph 110 of **Agenda Item 7–A** explains further the relationship between responses and monitoring activities.

## Communication

44. The QCTF has proposed a clearer differentiation between the need for ongoing communication of matters related to monitoring and remediation versus other communications about the system of quality management as a whole, such as annual communications. Ongoing communication about the results of the firm's monitoring and remediation is necessary so that firm personnel can appropriately respond to the information in a timely manner, which is similar to how extant ISQC 1 addresses communication. Other communications form part of the overall communications about the system of quality management, included in the information and communication component (see paragraph 29(d) of **Agenda Item 7–A**).
45. There are also new requirements that address the direct reporting to firm leadership to echo the importance of this communication channel and to involve firm leadership in decisions about further communication of matters related to monitoring and remediation.

## Annual Stand Back

46. The QCTF considered the IAASB comments regarding an annual evaluation and clarifying how the monitoring and remediation component relates to the firm's evaluation of whether the overall objective of the standard has been achieved. The approach in proposed ISQC 1 (Revised) emphasizes the need for:
  - (a) The firm to undertake monitoring activities over the system of quality management as a whole, i.e., moving beyond a focus on inspection of completed engagements to a more holistic and robust approach.
  - (b) Ongoing monitoring activities, and evaluating the results of such monitoring activities in a timely manner in order that deficiencies are identified and remediated.
47. In order to be responsive to the IAASB's comments, the QCTF has proposed a new requirement for the individual(s) assigned ultimate responsibility and accountability for the system of quality management to perform a stand back and evaluate whether the system of quality management provides the firm with reasonable assurance that the firm's objective is met. The stand back may be undertaken annually, or more frequently when circumstances arise that may affect whether the system provides the firm with reasonable assurance. The annual stand back would be a point-in-time assessment, i.e., it would not be for a past period because the system is designed to identify deficiencies and remediate them on an ongoing basis.
48. The standard recognizes that there may be circumstances when the firm determines that the system does not provide it with reasonable assurance that the firm's objectives are met, for example, deficiencies exist at the time of the evaluation that are significant, and the firm has not yet remediated the deficiencies. In such cases, proposed ISQC 1 (Revised) requires the firm to communicate this fact immediately to firm personnel and if appropriate, parties that are external to the firm.

### **Matters for IAASB Consideration**

10. The IAASB is asked to share their views regarding the proposals in relation to monitoring and remediation, in particular whether:
  - (a) The IAASB supports the proposed definition of deficiencies.

- (b) The framework for the identification and evaluation of deficiencies is clear.
11. Does the IAASB support the proposal that the individual(s) assigned ultimate responsibility and accountability for the system of quality management should perform a stand back, and:
- (a) Is the requirement understandable and clear?
- (b) If the requirement is not understandable and clear, what suggestions does the IAASB have regarding how the expectation can be clarified?

## General Structure of the Components

### *Summary of December 2017 IAASB Discussions*

49. At its December 2017 meeting, the IAASB:
- (a) Encouraged the QCTF to consider certain of the quality objectives, quality risks and required responses, noting that some of them appeared incorrectly classified between quality objectives, quality risks and responses.
- (b) Commented that the required responses appear as if they are the only responses the firm needs to implement in order to address the quality risks and achieve the quality objectives.
- (c) Encouraged greater linkage to quality management at the engagement level

### *Task Force Views*

50. The QCTF has made various changes to the structure and content of the components, including:
- (a) Reorganizing some of the prescribed quality objectives and required responses to bring better balance between them, and to establish more consistency across the components.
- (b) Rearticulating the requirements in each of the components for the firm to design and implement the responses, in order to clarify that these do not encompass all of the responses the firm needs to have in place.
- (c) Inserting the overarching purpose of the component in the lead in to the requirements for the firm to establish quality objectives, in order to clarify what the quality objectives need to address and to highlight that the prescribed quality objectives are not all inclusive.
51. The QCTF continues to liaise with the ISA 220 Task Force. The QCTF has considered whether there are appropriate linkages with proposed ISA 220 (Revised) and is satisfied that, at this point, the concepts of the standards are appropriately aligned, however recognizing that further progress will be made on proposed ISA 220 (Revised). In certain areas, the QCTF has included a placeholder for reference to proposed ISA 220 (Revised), until such time as further progress is made. The QCTF also notes the requirement for the firm to communicate the engagement team's responsibilities with respect to the implementation of responses and to establish policies or procedures addressing the exchange of information between the firm and engagement teams, that have been added to the standard (see paragraph 29(b) of **Agenda Item 7–A**).

## Governance and Leadership

### Summary of December 2017 IAASB Discussions

52. At its December 2017 meeting, the IAASB discussed:
- (a) Clarifying who are the relevant stakeholders in the context of the firm and more explicitly addressing the public interest and explaining what this means.
  - (b) Improving the emphasis on the firm's business strategy, or financial and operational priorities in relation to the firm's strategic decisions and actions.
  - (c) Clarifying the differentiation of the role of those assigned ultimate responsibility for the system of quality management and those assigned operational responsibility for the system of quality management.
  - (d) Placing the proposed requirement that requires the firm to appoint an individual responsible for independence in the governance and leadership component, and including application material to reflect the scalability of how this may be applied in different firms.

### Task Force Views

#### Public Interest and Relevant Stakeholders

53. The QCTF noted the varying views since the commencement of the project regarding an explicit reference to the term "public interest" in the standard, in particular concerns regarding the meaning of this term and how it can be measured if it were included in a requirement. The QCTF identified that paragraph 100.1 A1 of the International Ethics Standards Board for Accountants (IESBA) Code,<sup>8</sup> which forms part of the general provisions addressing compliance with the IESBA Code, refers to the responsibility to act in the public interest. The QCTF has therefore introduced a similar paragraph that explains the firm's responsibility in relation to acting in the public interest and:
- (a) Describes what acting in the public interest means.
  - (b) Explains that the needs of the firm's stakeholders may change over time (this emphasizes the firm's responsibility not merely to comply with the requirements of the standard, but to think beyond those requirements and address stakeholder needs and expectations).
  - (c) Notes how the firm's environment that focuses on the public interest role supports the performance of engagements.
54. Paragraph A22 of **Agenda Item 7–A** has been revised in order to clarify who are the relevant stakeholders.

#### Quality Objectives for Governance and Leadership

55. During the December 2017 IAASB discussion, it was suggested that the quality objectives be compared with the requirements in paragraph 14 of proposed ISA 315 (Revised) in relation to the entity's control environment. Appendix 5 includes this comparison and the QCTF is of the view that they are comparable, except for the principle addressing human resources. This principle is addressed in the resources component of proposed ISQC1 (Revised), which contains quality

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<sup>8</sup> The International Code of Ethics for Professional Accountants (including *International Independence Standards*), approved by the IESBA at its December 2017 meeting

objectives in relation to human and other types of resources that are more comprehensive than the requirements in paragraph 14 of proposed ISA 315 (Revised). The QCTF is of the view that it is not appropriate to duplicate requirements across components, and therefore addressing human resources in the governance and leadership component as well as the resources component would be inappropriate.

56. The QCTF has also amended the quality objectives addressing the firm's strategic decisions and actions to highlight that financial and operational priorities do not override the firm's commitment to quality. The QCTF does not think that it is appropriate to refer to "business strategy" in the requirements, given that a strategy may not be developed by all firms, in particular SMPs. Instead the requirements address the firm's strategic decisions and actions, which includes decisions in relation to the business strategy, if applicable.

#### Firm Leadership

57. The QCTF noted the IAASB's comments to refine the requirements in relation to who within the firm is assigned ultimate responsibility for the system of quality management. The SMP Committee had also commented on these provisions, noting that the terms "chief executive officer" and "managing board of partners" do not resonate with SMPs. The QCTF considered possible alternative terms, such as "those charged with governance" or "the individual(s) within the firm who is responsible for overseeing the firm's operations and allocating resources". The QCTF is of the view that neither of these terms help provide clarity, and using "those charged with governance" may cause confusion with how it is used in the ISAs. Therefore, the QCTF propose that the terms be retained, consistent with how they are used in extant ISQC 1, however in order to better resonate with SMPs, the phrase "managing partner" has been added to the requirement.
58. The QCTF has made various changes to the responses addressing the assignment of responsibilities to firm leadership, including:
- (a) Relocating the requirements for assigning responsibility for the independence and monitoring and remediation.
  - (b) Better differentiating between responses that the firm implements, versus those that are responsibilities of firm leadership.
  - (c) Clarifying the responsibilities of firm leadership in relation to the quality objectives. In this regard, the QCTF is of the view that it is necessary to explain these responsibilities, given the proposals in the Invitation to Comment (ITC), *Enhancing Audit Quality: A Focus on Professional Skepticism, Quality Control and Group Audits*, and support from respondents to the ITC to strengthen firm leadership's responsibilities.

#### **Matters for IAASB Consideration**

12. The IAASB is asked to share their views regarding the proposed requirements addressing governance and leadership.

## Information and Communication

### *Summary of December 2017 IAASB Discussions*

59. At its December 2017 meeting, the IAASB asked the QCTF to include more emphasis on two-way communication within the firm through improving the emphasis on firm personnel and the firm's responsibility to create an environment that supports communication. The IAASB also recommended that the requirements addressing communication should be differentiated from the need to obtain or generate information.

### *Task Force Views*

60. The QCTF considered the IAASB's suggestions and has amended the proposed quality objectives in order to:
- (a) Better differentiate between obtaining and generating information, from communicating information.
  - (b) Improve the focus on two-way communication within the firm and emphasize the responsibility of all firm personnel for communication.
61. The QCTF has also introduced a new communication requirement, in the form of a required response, for the communication to firm personnel of the evaluation of the system of quality management and relevant information in relation to the system of quality management, in particular changes in the system (see paragraph 29(d) of **Agenda Item 7–A**).
62. The QCTF also considered the extent to which the information and communication component:
- (a) Specifies the types of information that is obtained, generated and communicated, in relation to the information needs for the other components of the system of quality management; and
  - (b) The types of information systems that may be needed.

The QCTF is of the view that the other components of the system of quality management implicitly indicate the information that needs to be obtained, generated or communicated in order that the requirements of those components are met. As a result, in designing the system of quality management, the firm needs to understand the integration of the components and determine which information is needed for the components and how it should be obtained. Prescribing the information in the information and communication component could be contrary to this approach, and the overall principles-based nature of the standard that caters for the varying size and complexity of firms. Specifying the information needs or information systems would also result in lengthy requirements and could inadvertently omit information or information systems (i.e., there would be a completeness risk).

63. The QCTF notes that it has developed guidance that provides examples of the information that is relevant in supporting the functioning of the components of the system of quality management and examples of the matters that may be communicated between the firm and firm personnel or external parties. However, given the nature of this material it is proposed as supplementary guidance rather than application material supporting the standard (see paragraphs 12–17 of Appendix 1 of **Agenda Item 7–A**).

## Communication with External Parties - Including Transparency Reporting

64. The ITC included various proposals in relation to transparency reporting, for example, seeking to understand the demand and requirements for transparency reporting around the world, and how investors, regulators and others are using these reports, issuing guidance for firms, developing a thought piece or other non-authoritative material, or facilitating dialogue or encouraging research on the topic. Respondents to the ITC were generally supportive of the proposed actions in the ITC, noting that whatever actions the IAASB takes should not stifle innovation and the development of transparency reporting at a jurisdictional level. Nevertheless, investors and certain other respondents called for the IAASB to more specifically address transparency reports in the IAASB's standards. Appendix 2 provides a more detailed analysis of the respondents' views.
65. At both the March 2017 and September 2017 CAG meetings, the CAG noted the importance of transparency reporting and urged the IAASB to address the topic in a manner that promotes high quality transparency reports. Further matters raised by the CAG in relation to transparency reporting included:
- (a) Which firms should be required to prepare a transparency report. It was suggested that this could be based on the type of engagements undertaken by the firm, rather than the size of the firm.
  - (b) The type of information that should be provided. The CAG highlighted the value of information about the firm's governance, the quality objectives and quality risks and also about how quality is being monitored.
66. During its outreach in the fourth quarter of 2017 in relation to ISQC 1, outreach participants noted the value of transparency reports, however cautioned that standard setting on this topic at this stage could be premature.
67. The QCTF undertook research to establish what requirements or principles exist in various jurisdictions in relation to firms' transparency reports. Transparency reports are required in many jurisdictions, including the European Union (EU) (including the United Kingdom),<sup>9</sup> Australia<sup>10</sup> and Japan, and are typically required for firms that perform audits of public interest entities (PIEs) or certain listed entities. While not mandatory, transparency reports are also being produced by audit firms in the United States (US),<sup>11</sup> Canada and other regions, although in some instances these are published in order to comply with the requirements of the EU where the firm has a registration in an EU country. Appendix 6 provides a comparison of the November 2015 International Organization of Securities Commissions (IOSCO) report on *Transparency of Firms that Audit Public Companies* (IOSCO report), which considers practices employed by audit firms and provides a guide for transparency reporting, to the matters that are required to be communicated in transparency reports issued in the EU and Australia.
68. Various aspects of proposed ISQC 1 (Revised) address how the firm considers and interacts with its relevant stakeholders, for example, the consideration of the legitimate interests of relevant stakeholders is one of the quality objectives in governance and leadership, and the monitoring and remediation component includes a requirement for the firm to consider whether it is appropriate to

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<sup>9</sup> EU Regulation 537/2014, which applies to financial years commencing on or after June 17, 2016

<sup>10</sup> Sections 332–332G of the Corporations Act 2001

<sup>11</sup> In the US these are referred to as Audit Quality Reports.

communicate information in relation to monitoring and remediation to external parties, as part of the overall communication with external parties. However, recognizing the call from stakeholders to more explicitly address transparency reporting, the QCTF recommends that it be addressed in proposed ISQC 1 (Revised), but in a manner that promotes the exchange of valuable and informative communication about the firm's system of quality management with the firm's stakeholders and does not stifle innovation.

69. In particular, the QCTF is of the view that firms may communicate information about its system of quality management with external parties in a variety of ways and how firms communicate with external parties continues to evolve, i.e., the information may not need to be communicated in a formal transparency report (unless required by law or regulation). The QCTF is of the view that requirements that specifically address transparency reports may inadvertently discourage the exchange of valuable and informative communication with external parties because of its perceived formality and may inadvertently scope out other forms of communication about the system of quality management that serve a similar purpose as a transparency report. Accordingly, the QCTF proposals in proposed ISQC 1 (Revised) address communication with external parties more generally, rather than specifically focusing on transparency reports. The QCTF is of the view that the proposed requirements promote scalable application so that the communication is done in a manner relevant to the circumstances of the firm and does not obligate firms to communicate externally when there is no public interest benefit of doing so, such as in the case of a smaller firm.
70. The QCTF considered whether the requirements should address the attributes of the information communicated with external parties. The QCTF noted that there may be circumstances when certain attributes may not be applicable to communication about the firm's system of quality management, for example, an attribute addressing relevance to the circumstances of the firm may not apply in circumstances when the communication contains standard information (i.e., it is boilerplate). The QCTF considered how ISA 701<sup>12</sup> addresses the attributes of the communication of key audit matters, for example, how it addresses attributes such as succinctness and relevance. In this regard, the QCTF observed that these attributes are addressed in the application material in ISA 701. Following this approach, the QCTF therefore propose that the application material set out the attributes of the information communicated about the firm's system of quality management. The attributes in paragraph A61 of **Agenda Item 7–A** were developed taking into consideration:
- (a) The principles regarding the preparation and presentation of information in Section 220 of the IESBA Code.<sup>13</sup>

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<sup>12</sup> ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

<sup>13</sup> Paragraph R220.4 of the IESBA Code states that when preparing or presenting information, a professional accountant shall:

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

- (b) The recommended principles relating to the presentation of information in the IOSCO report.
- (c) Other sources where principles are established related to the communication of information relevant to the governance and operation of businesses, in particular, the International Integrated Reporting Council's (IIRC) *International Integrated Reporting Framework* (IR Framework) which sets out guiding principles and content elements for the preparation of integrated reports.<sup>14</sup>

71. The QCTF also considered whether minimum content requirements should be prescribed. However, doing so would be inappropriate as (i) not all forms of communication need to contain the same information, (ii) prescribing content would likely result in boilerplate reports, and (iii) the prescribed content may not address the possible information needs of a variety of stakeholders across jurisdictions. Nevertheless, recognizing the increasing use of transparency reports globally, the application material explains the type of content that may be included in such reports, and notes that communication about changes affecting the firm and how the system of quality management has responded to such change is particularly useful.

#### **Matters for IAASB Consideration**

- 13. The IAASB is asked to share their views regarding the information and communication component, including whether the IAASB supports the QCTF's conclusions not to specify the information needs and information systems.
- 14. The IAASB is asked to share their views regarding the proposals addressing communication with external parties, including:
  - (a) Whether the application material is appropriate, or portions of it should be located in a separate publication or the appendix.

#### **Relevant Ethical Requirements**

##### *Summary of December 2017 IAASB Discussions*

72. At its December 2017 meeting, the IAASB discussed:
- (a) The extent to which the requirements in proposed ISQC 1 (Revised) should highlight the various aspects of relevant ethical requirements.
  - (b) Including a requirement in the responses that addresses the firm establishing appropriate resources to support compliance with relevant ethical requirements.

##### *Task Force Views*

73. At their December 2017 meeting, the IESBA approved their restructured Code, that with the exception of the provisions addressing long association, comes into effect as follows:
- (a) Parts 1, 2 and 3 are effective as of June 15, 2019.

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<sup>14</sup> The content elements set out specific information that should be included in the integrated report, however the guiding principles were useful in developing principles that are relevant to the preparation of firms' transparency reports. The IIRC guiding principles include (i) strategic focus and future orientation; (ii) connectivity of information; (iii) stakeholder relationships; (iv) materiality; (v) conciseness; (vi) reliability and completeness; and (vii) consistency and comparability.

- (b) Part 4A is effective for audits of financial statements for periods beginning on or after June 15, 2019.
  - (c) Part 4B is effective for periods beginning on or after June 15, 2019; otherwise it is effective as of June 15, 2019.
74. The QCTF considered the restructured Code, in particular in relation to the Conceptual Framework in Section 120, which contains the revised approach to identifying, assessing and addressing threats to compliance with the fundamental principles of the Code. The proposed quality objectives and responses, including the related application material, has been developed based on the restructured Code. In doing so, the QCTF:
- (a) Considered the extent to which particular topics of the IESBA Code should be specifically referenced in proposed ISQC 1 (Revised), for example, independence, long association, non-compliance with laws and regulations (NOCLAR). The QCTF noted that the revised IESBA Code draws out independence as a discrete topic (note the change in the title of the Code to include “The International Independence Standards” and the explanation in paragraphs 400.6 and 900.5 of the IESBA Code, which state that the conceptual framework in Section 120 applies to independence as it does to the fundamental principles). Accordingly, the QCTF is of the view that it is appropriate to specifically reference independence in proposed ISQC 1 (Revised), however other specific topics should not be specifically mentioned in the requirements, since:
    - (a) They fall under the fundamental principles and pinpointing certain topics may inappropriately deemphasize other provisions of the IESBA Code.
    - (b) It may result in the IAASB having to continuously evaluate and update its standards in response to new topics addressed by the IESBA.
  - (b) Noted that extant ISQC 1 focuses on breaches of independence, yet Section R100.4 of the IESBA Code deals with breaches of any of the provisions of the IESBA Code. Accordingly, the aspects addressing breaches have been broadened to address all breaches of relevant ethical requirements, including independence requirements.
  - (c) Updated the requirements to reflect the revised conceptual framework in the IESBA Code that was amended largely as a result of the IESBA's Safeguards Project. In doing so, the QCTF concluded that it is important to highlight the reasonable and informed third party test in the application material, since firms may be subject to jurisdictional ethical requirements other than the IESBA Code that do not contain a similar principle.
75. The application material addressing relevant ethical requirements has also been updated to address changes in the IESBA Code. The QCTF debated the extent to which such application material should describe the principles and concepts of the Code and agreed that it is necessary for the application material to include some detail since not all jurisdictions apply the IESBA Code and a common understanding of ethical requirements is therefore needed. For example, proposed ISQC 1 (Revised) includes a description of the principles of ethical requirements and an explanation of the various aspects of the IESBA Code, including the conceptual framework and independence standards. However, the QCTF notes that the Agreed Upon Procedures Task Force has proposed a different level of detail in the working draft of proposed ISRS 4400 (Revised),<sup>15</sup> to be presented to the IAASB in March 2018.

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<sup>15</sup> International Standard on Related Services (ISRS) 4400, *Agreed-Upon Procedures Engagement*  
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76. The QCTF deliberated whether the required responses in the relevant ethical requirements component adequately reflect the responses that would be expected of all firms. The QCTF noted the following:

- (a) The interrelationship of the information and communication component with the other components of the system of quality management, including relevant ethical requirements. The QCTF is of the view that it would be inappropriate to include requirements addressing information and communication in the relevant ethical requirements component, given the reasons set out in paragraph 62 regarding identifying information and information systems in the standard.
- (b) That there is a strong interrelationship between the relevant ethical requirements component and the other components of the system of quality management. For example, the engagement performance component addresses the fulfillment of responsibilities at the engagement level, which would also apply to the fulfillment of ethical responsibilities at the engagement level.

Accordingly, the QCTF is of the view that although the responses in paragraph 34 of **Agenda Item 7–A** are simple, many of the responses in the other components also address relevant ethical requirements.

77. The QCTF considered the definition of relevant ethical requirements, and how this should be updated to reflect various changes in the IESBA Code, taking into account:

- (a) The new sections of the IESBA Code (Parts 1, 2, 3, 4A and 4B); and
- (b) The new requirement in Section R120.4 addressing the applicability of Part 2 to professional accountants in public practice.

However, the QCTF identified various complexities that may arise in revising the definition, including its wider application across the IAASB Standards, which require further analysis and discussion with the IESBA before presenting any proposals to the IAASB. Therefore, amendments to the definition have not been considered at this stage.

#### **Matters for IAASB Consideration**

- 15. The IAASB is asked to share their views regarding the relevant ethical requirements component, including:
  - (a) The extent to which particular topics of the IESBA Code should be specifically referenced in proposed ISQC 1 (Revised).
  - (b) The extent to which the application material should describe the principles and concepts of the IESBA Code, and whether this approach should be consistently applied across the IAASB's standards.
  - (c) Whether additional responses are necessary in relation to relevant ethical requirements.

#### **Acceptance and Continuance**

##### *Summary of December 2017 IAASB Discussions*

78. At its December 2017 meeting, the IAASB discussed:

- (a) Addressing circumstances when the firm does not have an option in accepting or continuing a client relationship or an engagement, such as in the case of the public sector.
- (b) The communication of information to engagement teams that has been obtained through the engagement acceptance and continuance process.

#### *Task Force Views*

79. The QCTF has reorganized the content of this component to bring better balance between the quality objectives and responses, consistent with the other components. Furthermore, the QCTF has:
- (a) Introduced a new response in order to respond to the IAASB request to address circumstances when the firm does not have a choice in accepting or continuing a client engagement.
  - (b) Included the “nature and circumstances of the engagement” as a further consideration for the firm in determining whether to accept or continue a client or engagement.
80. With respect to the communication of information to the engagement team, the QCTF is of the view that the overall requirements in the information and communication component include overarching principles addressing communication with the engagement team. The QCTF notes the discussion in paragraph 62 regarding specific requirements in proposed ISQC 1 (Revised) addressing information needs. However, the QCTF have included additional application material in paragraph A74 of **Agenda Item 7–A** to address the communication of matters related to acceptance and continuance to the engagement team.

#### **Matters for IAASB Consideration**

16. The IAASB is asked to share their views regarding the engagement acceptance and continuance component.

#### **Resources**

##### *Summary of December 2017 IAASB Discussions*

81. At its December 2017 meeting, the IAASB discussed further enhancing the objectives and related application material addressing technological resources, human resources and intellectual resources, including:
- (a) Clarifying the need to address financial resources.
  - (b) Adding a more forward-looking perspective and adding the consideration of the timeliness of the resource allocation and availability of resources.
  - (c) Recognizing that resource allocation decisions may have an effect on engagement level risks.

#### *Task Force Views*

82. The QCTF has reorganized the content of this component to bring better balance between the quality objectives and responses, consistent with the other components. The QCTF remains of the view that financial resources are important in supporting a system of quality management, however this is an overarching concept for which granular quality objectives are not necessary. Accordingly, the need to obtain, use and allocate financial resources is addressed in a general way, and it is up to the firm to determine the further quality objectives, quality risks and responses that are needed to support it.

Application material has been included in paragraph A82 of **Agenda Item 7–A** to further explain why financial resources are important to a system of quality management.

83. The QCTF agrees that the firm should have a forward-looking perspective in obtaining, using and allocating resources and that resourcing needs are often driven by the firm's strategic decisions. The QCTF has therefore proposed a change to the quality objective in the governance and leadership component addressing resource allocation, and has more explicitly addressed the anticipation of future needs in the quality objectives within the resources component (see paragraphs 20(d) and 38(a) of **Agenda Item 7–A**).
84. The QCTF has introduced a new response in order to address the relationship between resource allocation and engagement level risks (see paragraph 40(a) of **Agenda Item 7–A**).

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

85. The ITC included various proposals addressing human resources, engagement partner competency and engagement partner performance and rewards, including:
  - (a) The knowledge, skills and competence of firm personnel, appropriate continuity planning and the manner in which firm personnel are assigned to engagements.
  - (b) The skills and competency of the engagement partner and the engagement partner's responsibilities for leading by example and mentoring.
  - (c) The performance appraisals and remuneration of engagement partners, including how these are linked to engagement quality.
86. Appendix 2 provides a detailed analysis of the respondents' views. In general, respondents to the ITC:
  - (a) Supported recognition in the IAASB standards of the required competencies of the engagement partner in IES 8 (Revised).<sup>16</sup>
  - (b) Supported the proposal to address continuity planning in ISQC 1. Respondents also highlighted the importance of having the appropriate mix of competencies on the engagement team, including appropriate middle-level management.
  - (c) Supported the proposal to explain the responsibilities of an engagement partner for mentoring, coaching and leading by example.
  - (d) Commented regarding the need to update skills through continuing professional development, including in relation to developing areas, such as information technology.
87. Respondents however expressed mixed views regarding emphasizing the importance of providing timely and informative performance appraisals and evaluations, noting that in the case of SMPs, performance appraisals and evaluations need not be overly formalized. The QCTF noted that respondents appeared to support addressing engagement quality in relation to performance evaluations, but were more cautious around linking engagement quality to remuneration or other incentives.

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<sup>16</sup> International Education Standard (IES) 8, *Professional Competence for Engagement Partners Responsible for Audits of Financial Statements (Revised)*

88. The QCTF notes that the provisions addressing human resources in proposed ISQC 1 (Revised) have been enhanced from extant ISQC 1, including in relation to:
- (a) The technical competence, professional skills and professional values, ethics and attitudes needed to perform engagements and other roles in the firm.
  - (b) Linking proposed ISQC 1 (Revised) with the IES issued by the International Accounting Education Standards Board (IAESB), including IES 7<sup>17</sup> and IES 8 (Revised), in order to further highlight what knowledge, skills and competencies may be appropriate, and the importance of continued professional development.
  - (c) The responsibility of the firm to develop its personnel. This includes an emphasis on developing firm personnel on changes in relation to professional standards and technology, in order to address respondents' comments regarding the need to update skills in developing areas.
  - (d) Appropriate continuity planning. This is addressed through the overarching quality objective that places a focus on the anticipation of the firm's resourcing needs.
89. The QCTF debated the extent to which the standard should address performance appraisals and remuneration of all firm personnel in the context of quality, considering the views of respondents to the ITC. The QCTF agreed that firms may incentivize personnel in a variety of ways, other than through remuneration, including through promotion, reward or other incentives. The QCTF also recognizes the need for any requirements addressing performance appraisals and incentives to be scalable to facilitate application by SMPs. The proposals in proposed ISQC 1 (Revised) therefore were developed in a manner that:
- (a) Holds personnel accountable for their commitment to quality.
  - (b) Encourages the firm to evaluate firm personnel in a timely manner, but does not require performance evaluations or other formal means of evaluation.
  - (c) Encourages the firm to address compensation, promotion and other incentives with regard to firm personnel in a manner that is appropriate to the nature and circumstances of the firm. This has been developed in a manner to facilitate scalable application, for example, in the case of a small firm, monetary incentives may not be practical in relation to engagement partners, however the engagement partners may be driven by their reputation within the firm. The QCTF notes that in some cases it may not be possible for the firm to establish incentives, for example, in the case of a sole practitioner.
90. Paragraph 94 further explains the QCTF's approach to addressing engagement partner responsibilities (including responsibilities for mentoring, coaching and leading by example).

#### **Matters for IAASB Consideration**

17. The IAASB is asked to share their views regarding the resources component, in particular:
- (a) Whether the QCTF proposals to address the views of respondents to the ITC are appropriate, in particular in relation to performance evaluations and incentives.

<sup>17</sup> IES 7, *Continuing Professional Development* (2014)

## Engagement Performance

### Summary of December 2017 IAASB Discussions

91. At its December 2017 meeting, the IAASB discussed:
- (a) The location of the requirements in relation to EQC reviews (the IAASB in general agreed that the requirements should be located in this component).
  - (b) Improving the linkage between the component objective and the performance of an EQC review.
  - (c) Reflecting the discussions in relation to proposed ISA 220 (Revised) about the involvement of the engagement partner.

### Task Force Views

92. Since the December 2017 IAASB meeting, the QCTF has not had further discussions on EQC reviews, including in relation to proposed ISQC 2.<sup>18</sup> Accordingly, the material in proposed ISQC 1 (Revised) includes only placeholders related to this topic.
93. Nevertheless, the QCTF agreed that the overarching component objective, which now forms part of the lead-in to the requirement to establish quality objectives, could be improved to reflect a better linkage to EQC reviews. The QCTF further noted that a more explicit quality objective is needed relating to professional judgment at the engagement level, which has been added. In doing so, the QCTF noted that consultation and differences of opinion are in fact responses that support professional judgment, and therefore have been rearticulated as prescribed responses.
94. The QCTF will further consider the quality objectives addressing the involvement of the engagement partner, including emphasizing the responsibilities of the engagement partner for mentoring, coaching and leading by example. In doing so, the QCTF will liaise with the ISA 220 Task Force, as they continue to develop proposed ISA 220 (Revised).

### Matters for IAASB Consideration

18. The IAASB is asked to share their views regarding the engagement performance component.

## Networks and Service Providers

### Summary of December 2017 IAASB Discussions

95. At its December 2017 meeting, the IAASB:
- (a) Encouraged the QCTF to find a more suitable term in referring to network services.
  - (b) Asked the QCTF to further enhance the requirements, taking into consideration the “services model” (i.e., the principles of ISA 402<sup>19</sup>), and the “expert model” (i.e., the principles of ISA 620<sup>20</sup>).

<sup>18</sup> ISQC 2, *Engagement Quality Control Reviews*

<sup>19</sup> ISA 402, *Audit Considerations Relating to an Entity Using a Service Organization*

<sup>20</sup> ISA 620, *Using the Work of an Auditor's Expert*

- (c) Supported introducing requirements for circumstances when the firm uses third party service providers, and suggested that it could be included in the resources component.

#### Task Force Views

- 96. The QCTF extensively debated an alternative term or phrase to describe the various aspects of the firm's system of quality management that are obtained from the network. However, other terms or phrases the QCTF identified to describe the various network activities either inadvertently restricted the activities of the network further, lead to unnecessarily long requirements, or implied that a network would be required to implement a system of quality management.. Instead, the QCTF has introduced a new definition of network services. The QCTF notes that given the new definition of "responses" in proposed ISQC 1 (Revised), policies or procedures that are prescribed by the network are included in the term responses.
- 97. In developing the proposals presented to the IAASB in December 2017, the QCTF reconsidered the principles of ISA 402 and ISA 620, as suggested by the Board, however did not identify any relevant principles that had not already been included in the previous proposals.
- 98. The QCTF has included additional application material to provide clarification of the types of procedures the firm may undertake to understand the network's processes, which were developed from concepts in ISAE 3402<sup>21</sup> (see paragraph A142 of **Agenda Item 7–A**).
- 99. The QCTF has also developed a new section addressing service providers. In doing so, the QCTF used the concepts relating to network services, however recognizing the differences in the nature of the relationship between the firm and its network, and the firm and an external service provider. The QCTF considered placing this section within resources, however is of the view that services obtained from a service provider may include other aspects of the system of quality management, for example, monitoring, or EQC reviews.

#### Matters for IAASB Consideration

- 19. The IAASB is asked to share their views regarding the sections addressing networks and service providers.

#### Public Sector and Further Planned Outreach

- 100. In response to comments regarding the applicability of proposed ISQC 1 (Revised) to the public sector, the QCTF has proposed adding a reference to the public sector in the definition of "firm".
- 101. The QCTF plans to undertake outreach with various public sector constituents in the second quarter of 2018. As a result, the application material in **Agenda Item 7–A** in relation to the public sector has not yet been considered by the QCTF, as further input is needed from this stakeholder group. Nevertheless, the QCTF considered the appropriate placement of this application material, for example, whether it should remain in the application material or be relocated to the appendix, recognizing also that the considerations in relation to SMPs have been modified. The QCTF is of the view that relocating the guidance to an appendix may deemphasize the role and uniqueness of the public sector. However, if the result of outreach indicates that more extensive guidance is needed,

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<sup>21</sup> International Standard on Assurance Engagements (ISAE) 3402, *Assurance Reports on Controls at a Service Organization*

the appendix may be an appropriate location in order to retain the conciseness of the application material overall.

102. While the QCTF has not undertaken any outreach in the last quarter, the QCTF is in the process of setting up outreach in the second quarter of 2018, in order to solicit input on the practicality and inspectability of the proposals in proposed ISQC 1 (Revised).

**Matters for IAASB Consideration**

20. The IAASB is asked to share their views regarding:
- (a) The proposed change to the definition of “firm” to recognize the public sector.
  - (b) The practicality and inspectability of the proposals in proposed ISQC 1 (Revised).

## Appendix 1

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

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

#### **Task Force Activities Since Last IAASB Discussion**

2. Since the last IAASB discussion at the December 2017 IAASB meeting, the QCTF has met once in person and held two teleconferences. The Drafting Team of the QCTF met twice in person.

#### **Outreach**

3. There have been no outreach activities undertaken since the previous discussions with the IAASB. However, the QCTF has initiated dialogue with several stakeholders to schedule outreach in the second quarter of 2018. This includes the Global Public Policy Committee, SMP Committee, IFIAR Standards Coordination Working Group, National Standards Setters, and public sector constituents.

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

##### *ISA 220 Task Force*

4. Since the last IAASB discussion at the December 2017 IAASB meeting, the Chairs of the Task Forces, certain members of the respective drafting teams and staff of the respective projects held one meeting to discuss matters of mutual interest related to quality management at the firm level and quality management at the engagement level. Further coordination has also been facilitated through the overlap of Task Force members and staff liaison.

## Appendix 2

### Feedback from Respondents to the ITC<sup>22</sup>

#### Transparency Reporting

103. Investors<sup>23</sup> indicated support for actions related to transparency reporting, with a respondent<sup>24</sup> from this stakeholder group encouraging the IAASB to develop requirements for firms to produce transparency reports. Another<sup>25</sup> respondent thought that firms should be required to make disclosures in their transparency reports regarding audit quality and application of professional skepticism. These constituents<sup>26</sup> indicated that firms' transparency reporting has been positive, in particular reporting of key performance indicators, and there were also suggestions of specific matters that should be communicated in the transparency report.
104. Members of the monitoring group (MG)<sup>27</sup> were of the view that transparency reports issued by audit firms provide an opportunity for audit firms to distinguish themselves on aspects of audit quality and facilitate external scrutiny of a firm's quality control arrangements and enhances their accountability to external stakeholders. It was suggested that the IAASB could consider whether ISQC 1 has a role to play in transparency reporting,<sup>28</sup> for example, in application material, and considering experience in those jurisdictions where such reporting is already required. While supportive of the proposals in the ITC, another member of the MG<sup>29</sup> cautioned that actions taken by the IAASB should not affect the ability of a jurisdiction, securities regulator and/or audit oversight regulator to develop and implement its own requirements related to transparency reporting.
105. Regulators and audit oversight authorities<sup>30</sup> supported the IAASB's proposed actions in the ITC. Furthermore, certain respondents from this stakeholder group<sup>31</sup> encouraged the IAASB to consider whether the standards should address transparency reporting (e.g., through the development of international guidelines or principles on transparency reporting within ISQC 1). One respondent<sup>32</sup> explicitly supported addressing elements of transparency reports into ISQC 1. Respondents expressing their support for the actions in the ITC or enhancements to the standards noted that transparency reporting could positively contribute to audit quality as it:
- (a) Allows external scrutiny of the firm's quality control.<sup>33</sup>

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<sup>22</sup> Appendix 3 includes a list of respondents to the ITC

<sup>23</sup> *Investors and Analysts*: CFA, IA, NZSA, SAAJ

<sup>24</sup> *Investors and Analysts*: IA

<sup>25</sup> *Investors and Analysts*: SAAJ

<sup>26</sup> *Investors and Analysts*: CFA, IA, NZSA

<sup>27</sup> *MG*: IAIS, IFIAR

<sup>28</sup> *MG*: IAIS, IFIAR

<sup>29</sup> *MG*: IOSCO

<sup>30</sup> *Regulators and Audit Oversight Authorities*: CPAB, ESMA, UKFRC

<sup>31</sup> *Regulators and Audit Oversight Authorities*: CPAB, IRBA, UKFRC

<sup>32</sup> *Regulators and Audit Oversight Authorities*: ESMA

<sup>33</sup> *Regulators and Audit Oversight Authorities*: ESMA, IRBA

- (b) Enhances accountability to external stakeholders.<sup>34</sup>
  - (c) Is the only realistic means to increase confidence in the firms' governance structures.<sup>35</sup>
106. Regulators and audit oversight authorities suggested the following further actions the IAASB could take in exploring the topic:
- (a) Research into the usefulness of transparency reports and whether they contribute to improving audit quality.<sup>36</sup>
  - (b) Analyzing and understanding the current practices and requirements amongst the jurisdictions with a view to achieving global consistency.<sup>37</sup>
  - (c) Determining what type of assurance is needed over a transparency report.<sup>38</sup>
107. Furthermore, a regulator<sup>39</sup> noted that the introduction of transparency reports in the United Kingdom has been a positive development, although further improvements could be made if firms adopt a more tailored approach and include content which is less boilerplate and of greater relevance to investors, regulators and other stakeholders.
108. Respondents across other stakeholders groups noted that flexibility is necessary to allow innovation<sup>40</sup> and overall had mixed views regarding the IAASB's possible actions relating to transparency reporting, including:
- (a) Support<sup>41</sup> for the proposed actions in the ITC, in particular, facilitating ongoing dialogue and encouraging research.
  - (b) Support<sup>42</sup> for the IAASB to encourage firms to produce transparency reports on a voluntary basis.
  - (c) Support for the IAASB to provide guidelines on best practices.<sup>43</sup>
  - (d) Focusing the IAASB's efforts elsewhere at this stage, since (i) transparency reporting is in its infancy and efforts should be focused on other more urgent projects; and (ii) any actions could

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<sup>34</sup> *Regulators and Audit Oversight Authorities: ESMA, IRBA*

<sup>35</sup> *Regulators and Audit Oversight Authorities: UKFRC*

<sup>36</sup> *Regulators and Audit Oversight Authorities: CPAB, IRBA*

<sup>37</sup> *Regulators and Audit Oversight Authorities: IRBA, UKFRC*

<sup>38</sup> *Regulators and Audit Oversight Authorities: IRBA, UKFRC*

<sup>39</sup> *Regulators and Audit Oversight Authorities: UKFRC*

<sup>40</sup> *National Standard Setters(NSS): CNCC-CSOEC; Accounting Firms: DTT, PWC; Member Bodies and Other Professional Organizations: ICAEW, SAICA*

<sup>41</sup> *NSS: AUASB, CNCC-CSOEC, JICPA, MAASB, NZAuASB; Accounting Firms: RSM, PWC; Public Sector Organizations: AGC, AGSA, INTOSAI; Member Bodies and Other Professional Organizations: ACCA, CAANZ, CPAA, EFAA, FEE, ICAEW, ICAS, ICAZ, ICPAK, SAICA, SMPC; Academics: AAA; Individuals and Others: DAHughes, SDeViney*

<sup>42</sup> *Accounting Firms: CHI*

<sup>43</sup> *Member Bodies and Other Professional Organizations: ICAEW*

stifle innovation and firms have been preparing transparency reports for many years and have well developed practices.<sup>44</sup>

109. With respect to network firms, a firm and a member body<sup>45</sup> suggested that the transparency report could be a useful tool to be used by a firm to evaluate the firm's reliance on network firm quality control and monitoring policies and procedures. These respondents were supportive of the standard addressing to what extent the transparency report could be helpful. A firm<sup>46</sup> noted that a number of network firms currently publish annual transparency reports that describe audit quality systems in place and the steps taken to safeguard the firm's independence.
110. Respondents<sup>47</sup> raised concerns with respect to transparency reporting in the context of SMPs. They explained that transparency reporting could impair the SMP's privacy, since for sole practitioners, there is no distinction between the firm and the individual; details about the firm can be directly attributed to the practitioner personally. Furthermore, with small client bases, any disclosures related to clients may allow others to surmise client identities.
111. In addition, it was believed<sup>48</sup> that any requirements related to transparency reporting would impose burdens on SMPs that outweigh the public interest. Moreover, it could widen the public perception of differences between larger and smaller firms if the IAASB standards were to require some firms to publish transparency reports and others not.

#### *Audit Quality Indicators*

112. Respondents also commented on the use of audit quality indicators (AQIs). A member body<sup>49</sup> noted that transparency reporting is the preferred tool to communicate on AQIs, while a regulator<sup>50</sup> was of the view that AQIs provide an opportunity to enhance discussions between auditors and audit committees, and benefit audit committees in fulfilling their responsibilities relative to the oversight of an audit, as well as enabling audit firms, audit regulators and audit standard-setters to better track and assess improvements in audit quality over time. A member body<sup>51</sup> suggested that the IAASB issue supplementary guidance regarding the use of AQIs based on the Framework for Audit Quality,<sup>52</sup> as there are currently a wide variety of approaches to AQI's internationally.

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<sup>44</sup> NSS: CAASB, IDW; *Accounting Firms*: BDO, DTT, EYG; *Member Bodies and Other Professional Organizations*: AICPA, KICPA; *Individuals and Others*: JGrant

<sup>45</sup> *Accounting Firms*: KPMG; *Member Bodies and Other Professional Organizations*: WPK

<sup>46</sup> *Accounting Firms*: EYG

<sup>47</sup> *Member Bodies and Other Professional Organizations*: AICPA, ICAEW

<sup>48</sup> *Member Bodies and Other Professional Organizations*: SMPC

<sup>49</sup> *Member Bodies and Other Professional Organizations*: FEE

<sup>50</sup> *Regulators and Audit Oversight Authorities*: IRBA

<sup>51</sup> *Member Bodies and Other Professional Organizations*: ICAEW

<sup>52</sup> *A Framework for Audit Quality: Key Elements that Create an Environment for Audit Quality*

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

113. An investor<sup>53</sup> noted the importance of the engagement team having the appropriate structure, including sufficient middle-ranking personnel to perform the engagement.
114. In relation to the proposals addressing engagement partner performance and rewards,<sup>54</sup> respondents overall expressed mixed views regarding taking engagement quality into consideration within engagement partners' compensation, although there was more support for addressing engagement quality in relation to performance evaluations. Comments and views expressed in this regard were as follows:
- (a) Support for the proposals, including from regulators,<sup>55</sup> although in general respondents<sup>56</sup> noted that this would need to be achieved through principles-based requirements, or at most addressed in application material.<sup>57</sup>
  - (b) No support for the proposals in general, with respondents noting that ISQC 1 already appropriately addresses this topic.<sup>58</sup>
  - (c) Concern, including from a member of the monitoring group,<sup>59</sup> that linking engagement partner rewards or incentives to audit quality could have unintended negative consequences and there is a lack of a common metric for measuring audit quality. However, some of these respondents and others<sup>60</sup> supported addressing audit quality in relation to the performance evaluations of individuals (rather than incentives and remuneration).
  - (d) A suggestion from regulators<sup>61</sup> that engagement quality should be taken into consideration in performance evaluations for all firm personnel (i.e., not only engagement partners). However another respondent from an accounting firm was of the view that the focus should be on the individuals within the firm responsible for quality.<sup>62</sup>

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<sup>53</sup> *Investors and Analysts: IA*

<sup>54</sup> The terms rewards, compensation and incentives were used by respondents to the ITC. The QCTF is of the view that firms may have various types of incentives or rewards that include compensation.

<sup>55</sup> *Regulators and Audit Oversight Authorities: CPAB, IAIS, IFIAR, IRBA; National Standard Setters: NBA, CNCC-CSOEC, IDW, JICPA, NBA; Accounting Firms: BDO, GTI, KPMG; Public Sector Organizations: AGSA; Member Bodies and Other Professional Organizations: AICPA, IBRACON, IBR-IRE*

<sup>56</sup> *Regulators and Audit Oversight Authorities: IRBA, UKFRC; National Standard Setters: AUASB, CNCC-CSOEC, IDW; Accounting Firms: BDO, EYG, PWC*

<sup>57</sup> *Member Bodies and Other Professional Organizations: ICAEW*

<sup>58</sup> *National Standard Setters: CAASB; Accounting Firms: DTT; Public Sector Organizations: GAO; Member Bodies and Other Professional Organizations: ACCA, CAANZ, ICAZ, ISCA, KICPA; Individuals and Others: DAHughes, SDeViney*

<sup>59</sup> *Regulators and Audit Oversight Authorities: IOSCO; National Standard Setters: NZAuASB; Member Bodies and Other Professional Organizations: CPAA, FEE, ICAS, ICPAK, SMPC*

<sup>60</sup> *Regulators and Audit Oversight Authorities: IOSCO; Accounting Firms: CHI; Member Bodies and Other Professional Organizations: FEE*

<sup>61</sup> *Regulators and Audit Oversight Authorities: IOSCO, UKFRC*

<sup>62</sup> *Accounting Firms: EYG*

- (e) Placing an emphasis on positive outcomes or high quality, i.e., not focus on negative outcomes.<sup>63</sup>
  - (f) That it would be impracticable for SMPs to implement requirements in this regard.<sup>64</sup>
115. Respondents did not in general comment extensively regarding the proposals to more explicitly reference the IESBA Code provisions addressing non-assurance services and other relevant aspects. Respondents who did comment in this regard did not support any actions or supported only a reference to the IESBA Code.<sup>65</sup>
116. Regulators commented variously on the aspect of human resources, including engagement partner competency as follows:
- (a) A regulator<sup>66</sup> supported the proposal to address career development and promotion by emphasizing the importance of providing timely and informative performance appraisals and evaluations. This respondent also supported the proposals to address continuity planning and consideration of the relationship between IES 8 (Revised) and the IAASB Standards.
  - (b) Another regulator<sup>67</sup> suggested that ISQC 1 could address personnel skills, both in the recruitment process and in maintaining them, and further highlighted the importance of maintaining skills in emerging areas (i.e., information technology).
  - (c) A member of the MG<sup>68</sup> emphasized the importance of sufficient time and resources to undertake engagements, timely performance appraisals and coaching, and adequate training particularly in specialized industries.
117. Respondents from other groups<sup>69</sup> supported a more explicit reference to the competencies of the engagement partner in IES 8 (Revised), or clarifying the relationship between IES 8 (Revised) and the IAASB Standards however in general did not support replicating the concepts in the IAASB Standards. They further supported in relation to ISQC 1:
- (a) Addressing continuity planning.<sup>70</sup> In assigning personnel, a respondent<sup>71</sup> suggested addressing the appropriate mix of competencies on the engagement team. Other respondents<sup>72</sup> were of the view that this should be addressed through the new quality

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<sup>63</sup> *National Standard Setters:* JICPA; *Accounting Firms:* BDO; *Member Bodies and Other Professional Organizations:* APESB, IBR-IRE

<sup>64</sup> *National Standard Setters:* IDW; *Accounting Firms:* RSM; *Member Bodies and Other Professional Organizations:* ACCA, ISCA, KICPA, SMPC

<sup>65</sup> *Accounting Firms:* DTI, EYG; *Member Bodies and Other Professional Organizations:* APESB, CPAA, KICPA

<sup>66</sup> *Regulators and Audit Oversight Authorities:* UKFRC

<sup>67</sup> *Regulators and Audit Oversight Authorities:* H3C

<sup>68</sup> *Regulators and Audit Oversight Authorities:* IAIS

<sup>69</sup> *National Standard Setters:* AUASB, CNCC-CSOEC, HKICPA, IDW, MAASB, NZAuASB, *Accounting Firms:* BDO, CHI, EYG, GTI, PWC, RSM; *Public Sector Organizations:* AGSA, GAO; *Member Bodies and Other Professional Organizations:* AICPA, CAANZ, CPAA, FEE, IBR-IRE, ICAEW, ICAZ, SMPC; *Individuals and Others:* DAHughes

<sup>70</sup> *National Standard Setters:* CNCC-CSOEC; *Accounting Firms:* BDO, RSM; *Public Sector Organizations:* AGSA; *Member Bodies and Other Professional Organizations:* AICPA, CPAA, IBRACON, ICAZ

<sup>71</sup> *National Standard Setters:* AUASB, CNCC-CSOEC, HKICPA, IDW, MAASB

<sup>72</sup> *Accounting Firms:* EYG, PWC

management approach, i.e., as a risk related to the skills and competencies of the engagement team. It was noted by a respondent that this is an area of challenge for SMPs.<sup>73</sup>

- (b) Addressing career development and promotion by emphasizing the importance of providing timely and informative performance appraisals and evaluations,<sup>74</sup> although there was a respondent who suggested that this be addressed outside of the standards.<sup>75</sup> It was further noted that this should not be overly formalized, particularly as it applies to SMPs.<sup>76</sup>
- (c) Explaining the responsibilities of an engagement partner for mentoring, coaching and leading by example.<sup>77</sup>
- (d) Emphasizing that financial considerations should not undermine quality objectives.<sup>78</sup>

However, other respondents<sup>79</sup> were of the view that the provisions in extant ISQC 1 addressing human resources are generally appropriate. One respondent<sup>80</sup> noted that formal staff assessments is “old fashioned”, i.e., instant and honest feedback is a preferred method in today’s environment. Two respondents<sup>81</sup> also did not support the proposal to address maintaining evidence of the firm’s activities to address the requirements.

118. Two respondents<sup>82</sup> highlighted the importance of the impact of technology on the competencies of the engagement partner or engagement team, while another public sector respondent<sup>83</sup> noted the need for project management skills. Various respondents<sup>84</sup> commented on the importance of staff retention and the challenges in today’s environment in retaining individuals within the profession.

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<sup>73</sup> *Member Bodies and Other Professional Organizations: FEE*

<sup>74</sup> *Accounting Firms: BDO, CHI, PWC; Public Sector Organizations: AGSA; Member Bodies and Other Professional Organizations: ICAP, ICAZ*

<sup>75</sup> *Accounting Firms: BDO*

<sup>76</sup> *Member Bodies and Other Professional Organizations: AICPA, CPAA*

<sup>77</sup> *National Standard Setters: MAASB, NBA; Accounting Firms: BDO, PWC; Public Sector Organizations: AGSA; Member Bodies and Other Professional Organizations: CPAA, FEE, ICAEW, ICAP; Individuals and Others: DAHughes*

<sup>78</sup> *Accounting Firms: BDO; Member Bodies and Other Professional Organizations: CPAA*

<sup>79</sup> *National Standard Setters: CAASB, JICPA; Accounting Firms: DTT; Member Bodies and Other Professional Organizations: ACCA*

<sup>80</sup> *Member Bodies and Other Professional Organizations: EFAA*

<sup>81</sup> *Accounting Firms: EYG; Member Bodies and Other Professional Organizations: SMPC*

<sup>82</sup> *Accounting Firms: PWC; Member Bodies and Other Professional Organizations: ICAEW*

<sup>83</sup> *Public Sector Organizations: AGSA*

<sup>84</sup> *National Standard Setters: CNCC-CSOEC; Member Bodies and Other Professional Organizations: FEE, ICAS, SMPC*

## Appendix 3

### List of Respondents to the ITC

**Note:** Members of the Monitoring Group are shown in bold below.

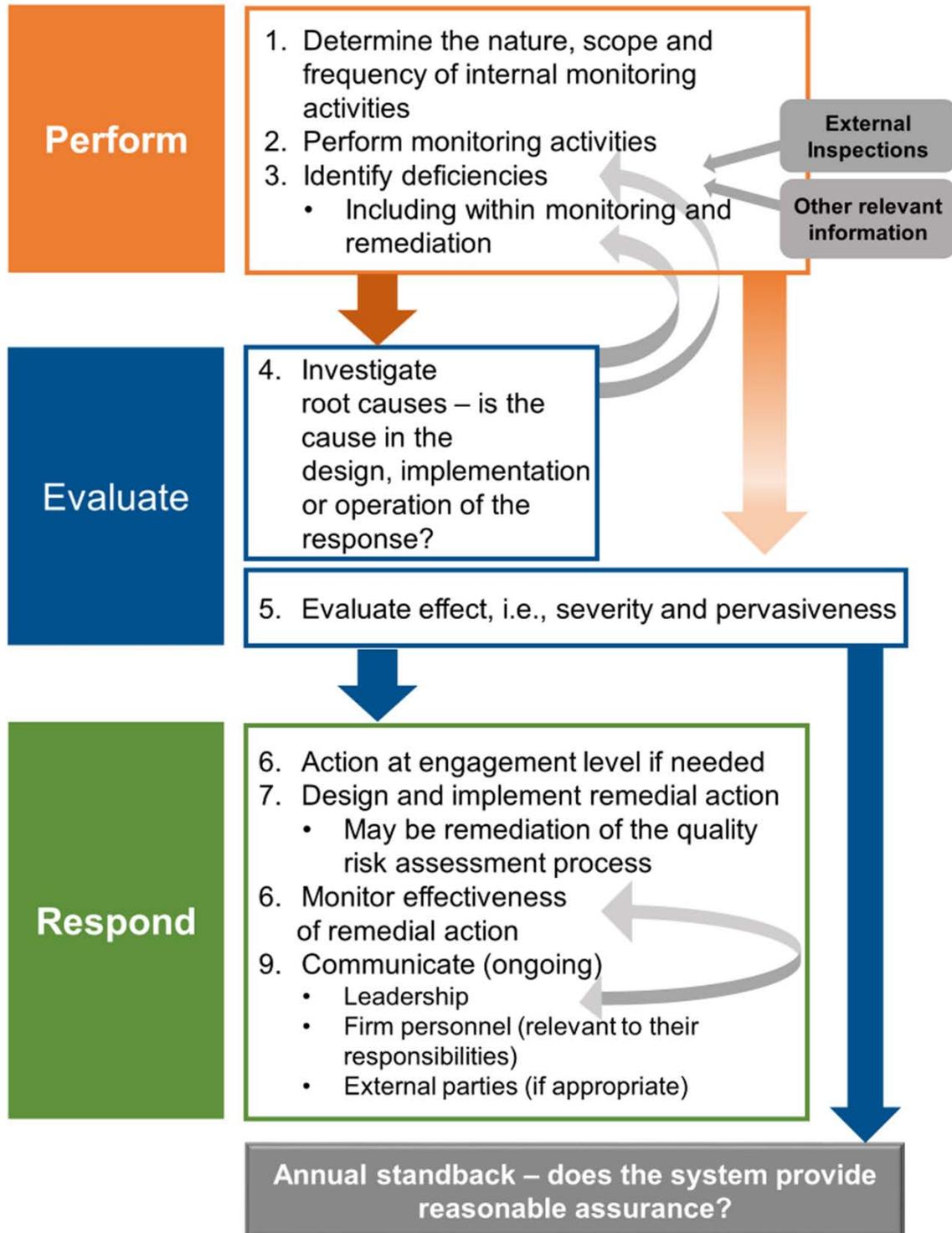
#	Abbrev.	Respondent (87)	Region
<b>Investors and Analysts (7)</b>			
1.	CalPERS	California Public Employees' Retirement System	NA
2.	CalSTRS	California State Teachers' Retirement System	NA
3.	CFA	CFA Institute	GLOBAL
4.	IA	The Investment Association	EU
5.	ICGN	International Corporate Governance Network	GLOBAL
6.	NZSA	New Zealand Shareholders Association	AP
7.	SAAJ	The Securities Analysts Association of Japan	AP
<b>Those Charged with Governance (1)</b>			
8.	AICD	The Australian Institute of Company Directors	AP
<b>Regulators and Audit Oversight Authorities (12)</b>			
<b>9.</b>	<b>BCBS</b>	<b>Basel Committee on Banking Supervision</b>	<b>GLOBAL</b>
10.	CPAB	Canadian Public Accountability Board	NA
11.	EAIG	European Audit Inspection Group (21 European Audit Regulators)	EU
12.	EBA	European Banking Authority	EU
13.	ESMA	European Securities and Markets Authority	EU
14.	H3C	Haut conseil du commissariat aux comptes	EU
<b>15.</b>	<b>IAIS</b>	<b>International Association of Insurance Supervisors</b>	<b>GLOBAL</b>
<b>16.</b>	<b>IFIAR</b>	<b>International Forum of Independent Audit Regulators</b>	<b>GLOBAL</b>
<b>17.</b>	<b>IOSCO</b>	<b>International Organization of Securities Commissions</b>	<b>GLOBAL</b>
18.	IRBA	Independent Regulatory Board for Auditors (South Africa)	MEA
19.	MAOB	Securities Commission of Malaysia - Audit Oversight Board	AP
20.	UKFRC	Financial Reporting Council – UK	EU
<b>National Auditing Standard Setters (9)</b>			
21.	AUASB	Australian Auditing and Assurance Standards Board	AP
22.	CAASB	Canadian Auditing and Assurance Standards Board	NA
23.	CNCC- CSOEC	Compagnie Nationale des Commissaires aux Comptes and the Conseil Supérieur de l'Ordre des Experts-Comptables	EU
24.	HKICPA	Hong Kong Institute of Certified Public Accountants	AP

#	Abbrev.	Respondent (87)	Region
25.	IDW	Institut der Wirtschaftspruefer	EU
26.	JICPA	The Japanese Institute of Certified Public Accountants	AP
27.	MAASB	Auditing and Assurance Standards Board of Malaysian Institute of Accountants	AP
28.	NBA	Nederlandse Beroepsorganisatie van Accountants (Royal NBA)	EU
29.	NZAuASB	New Zealand Auditing and Assurance Standards Board	AP
<b>Accounting Firms (10)</b>			
30.	BDO	BDO International Limited	GLOBAL
31.	CHI	Crowe Horwath International	GLOBAL
32.	DTT	Deloitte Touche Tohmatsu Limited	GLOBAL
33.	EYG	Ernst & Young Global Limited	GLOBAL
34.	GTI	Grant Thornton International Ltd	GLOBAL
35.	KPMG	KPMG IFRG Limited (Network)	GLOBAL
36.	PWC	PricewaterhouseCoopers International Limited	GLOBAL
37.	RBI	Russell Bedford International	GLOBAL
38.	RSM	RSM International	GLOBAL
39.	SRA	SRA (Samenwerkende Register Accountants) (Netherlands Network)	EU
<b>Public Sector Organizations (4)</b>			
40.	AGC	Auditor General Canada	NA
41.	AGSA	Auditor General South Africa	MEA
42.	GAO	United States Government Accountability Office	NA
43.	INTOSAI	Financial Audit Subcommittee of INTOSAI	MEA
<b>Preparers of Financial Statements (1)</b>			
44.	PAIB	IFAC Professional Accountants in Business Committee	GLOBAL
<b>Member Bodies and Other Professional Organizations (32)</b>			
45.	AAT	Association of Accounting Technicians	GLOBAL
46.	ACCA	Association of Chartered Certified Accountants	GLOBAL
47.	AIC	Asociación Interamericana de Contabilidad	SA
48.	AICPA	The American Institute of Certified Public Accountants	NA
49.	APESB	Accounting Professional & Ethical Standards Board Limited	AP
50.	CAANZ	Chartered Accountants Australia and New Zealand	AP
51.	CAI	Chartered Accountants Ireland – Audit and Assurance Committee	EU
52.	CAQ	Center for Audit Quality	NA

#	Abbrev.	Respondent (87)	Region
53.	CIIPA	Cayman Islands Institute of Professional Accountants	NA
54.	CIMA	Chartered Institute of Management Accountants	GLOBAL
55.	CPAA	CPA Australia	AP
56.	DnR	Den norske Revisorforening (DnR) – Norwegian Institute of Public Accountants	EU
57.	EFAA	European Federation of Accountants and Auditors for SMEs	EU
58.	FACPCE	Federación Argentina de Consejos Profesionales de Ciencias Económicas (Argentine Federation of Professionals Councils of Economic Sciences)	SA
59.	FEE	Fédération des Experts comptables Européens - Federation of European Accountants	EU
60.	FSR	Foreningen af Statsautoriserede Revisorer (Danish Institute of Accountants)	EU
61.	IBA	International Bar Association – Capital Markets Forum	GLOBAL
62.	IBRACON	Instituto dos Auditores Independentes do Brasil	SA
63.	IRE-IBR	Institut des Réviseurs d'Entreprises/Instituut van de Bedrijfsrevisoren	EU
64.	ICAEW	Institute of Chartered Accountants in England and Wales	EU
65.	ICAP	Institute of Chartered Accountants of Pakistan	AP
66.	ICAS	Institute of Chartered Accountants of Scotland	EU
67.	ICAZ	Institute of Chartered Accountants of Zimbabwe	MEA
68.	ICPAK	Institute of Certified Public Accountants of Kenya	MEA
69.	ICPAU	Institute of Certified Public Accountants of Uganda	MEA
70.	INCPC	Instituto Nacional de Contadores Públicos de Colombia	SA
71.	ISCA	Institute of Singapore Chartered Accountants	AP
72.	KICPA	Korean Institute of Certified Public Accountants	AP
73.	MICPA	The Malaysian Institute of Certified Public Accountants	AP
74.	SAICA	South African Institute of Chartered Accountants	MEA
75.	SMPC	IFAC Small and Medium Practices Committee	GLOBAL
76.	WPK	The Wirtschaftsprüferkammer	EU
<b>Academics (4)</b>			
77.	AAA	American Accounting Association – Auditing Section	NA
78.	AH	Andrew Higson	EU
79.	Glover-Prawitt	Professors Steven Glover and Douglas Prawitt - Brigham Young University	NA
80.	TRay	Thomas Ray	NA

#	Abbrev.	Respondent (87)	Region
<b>Individuals and Others (7)</b>			
81.	CBarnard	Chris Barnard	EU
82.	CK	Constance Kawelenga (ZUVA)	MEA
83.	DAHughes	Dianne Azoor Hughes	AP
84.	JGrant	JEC Grant	EU
85.	JK	John Kelly	NA
86.	KKTuraga	Krishna Kumar Turaga	AP
87.	SDeViney	Scott DeViney, CPA	NA

**Process Flow of the Monitoring and Remediation Process**



**Appendix 5**

**Comparison of Paragraph 14 of Proposed ISA 315 (Revised) to the Quality Objectives in Governance and Leadership**

Paragraph 14 of Proposed ISA 315 (Revised)	Quality Objectives in Governance and Leadership in Proposed ISQC 1 (Revised)
Demonstrates a commitment to integrity and ethical values;	<p>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.</p> <p>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.</p>
Demonstrates that those charged with governance are independent of management and exercise oversight of the entity’s system of internal control	Not applicable to ISQC 1
Establishes, with the oversight of those charged with governance, structures, reporting lines, and appropriate authorities and responsibilities, in pursuit of its objectives	<p>The firm has leadership who are responsible and accountable for quality.</p> <p>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.</p>
Demonstrates a commitment to attract, develop, and retain competent individuals in alignment with its objectives	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.
Holds individuals accountable for their internal control responsibilities in the pursuit of its objectives	<p>The firm has leadership who are responsible and accountable for quality.</p> <p>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.</p>

## Appendix 6

### Transparency Reporting: Comparison of IOSCO’s Report with the European Union and Australian Requirements

IOSCO’s Report	European Union	Australian
<p>Information about the audit firm’s legal and governance structure.</p>	<p>Description of the legal structure and ownership and governance of the audit firm.</p> <p>Whether the statutory auditor or the audit firm is a member of a network, a description of the network; the name of each statutory auditor operating as a sole practitioner; the countries in which they operate and the total turnover achieved resulting from the statutory audit of annual and consolidated financial statements.</p>	<p>Description of the audit firm’s network, legal and structural arrangement of the network.</p>
<p>Information about the audit firm’s measures to foster audit quality.</p>	<p>Description of the internal quality control system of the statutory auditor or of the audit firm and a statement by the administrative or management body on the effectiveness of its functioning.</p>	<p>Description of the auditor’s internal quality control system.</p>
<p>Information about the audit firm’s internal indicators of audit quality including:</p> <ul style="list-style-type: none"> <li>• Significant areas for improvement from the results of the audit firm’s internal monitoring of its implementation of regulatory and other requirements in areas such as professional continuing education, acceptance and continuance of clients and engagements, auditor independence of the audit</li> </ul>	<p>Statement concerning the statutory auditor’s or the audit firm’s independence practices which also confirms that an internal review of independence compliance has been conducted.</p> <p>Statement on the policy followed by the statutory auditor or the audit firm concerning the continuing education of statutory auditors referred to in</p>	<p>Statement that sets out the auditor’s independence practices in the relevant reporting year.</p> <p>Statement about the firm or company’s policy on the minimum amount and nature of continuing or other professional education that professional members of an audit team must undertake during the relevant reporting year.</p>

IOSCO's Report	European Union	Australian
<p>firm and its staff and system of quality control, and the corresponding remedial actions.</p>	<p>Article 13 of Directive 2006/43/EC.</p>	
<ul style="list-style-type: none"> <li>Proportion of revenues from non-audit services to audit and to non-audit clients; and indicator(s) of the years of experience of partners and staff.</li> </ul>	<p>Information about the total turnover of the statutory auditor or the audit firm, divided into the following categories:</p> <ul style="list-style-type: none"> <li>Revenues from the statutory audit of annual and consolidated financial statements of public-interest entities and entities belonging to a group of undertakings whose parent undertaking is a public-interest entity and from other entities;</li> <li>Revenues from permitted non-audit services to entities that are audited by the statutory auditor or the audit firm and from non-audit services to other entities.</li> </ul>	<p>Financial information for the auditor that relates to the relevant reporting year, including:</p> <p>Total revenue and revenue relating to audits of financial statements conducted by the auditor and other services provided by the auditor.</p>
<p>Information about the audit firm's indicators of audit quality as generated by the work of external bodies.</p>		
<p>Frequency of reports.</p>		
<p>Circulation of transparency reports.</p>		
	<p>Information concerning the basis for the partners' remuneration in audit firms.</p>	<p>Information about the basis for remuneration of the firm's partners or the company's directors.</p>
	<p>An indication of when the last quality assurance review</p>	<p>The name of each body that is authorized to review the auditor</p>

IOSCO's Report	European Union	Australian
	referred to in Article 26 was carried out.	(e.g. ASIC or a professional accounting body) and the date of the most recent review of the auditor conducted by the body
	A list of public-interest entities for which the statutory auditor or the audit firm carried out statutory audits during the preceding financial year.	The names of the relevant bodies in section 322 of the Corporations Act for which the auditor conducted an audit under Div 3 of Pt 2M.3 in the relevant reporting year.
	<p>Other mandatory Requirements</p> <p>Description of the statutory auditor's or the audit firm's policy concerning the rotation of key audit partners and staff in accordance with Article 17(7).</p>	<p>Other Voluntary Requirements</p> <ul style="list-style-type: none"> <li>• Network policy monitoring</li> <li>• Actions to improve and maintain audit quality</li> <li>• Internal indicators of audit quality</li> <li>• Findings from ASIC inspections</li> <li>• Findings from external reviews</li> </ul>