

FOR REFERENCE**Draft Appendix of International Standard on Quality Control 1 (Revised)****The Components of a System of Quality Management**

1. This appendix further explains the eight components of a firm's system of quality management. The components in this ISQC have similarities to the components of internal control described in ISA 315 (Revised).¹ For example, the governance and leadership component is similar to the entity's control environment and the firm's risk assessment process is similar to the entity's risk assessment process.

The Firm's Risk Assessment Process

2. The firm's risk assessment process includes the procedures undertaken by the firm to establish quality objectives relating to the other seven components of the system of quality management, and identify and assess quality risks to the achievement of the quality objectives. This is necessary so that the firm can identify those quality risks that are not at an acceptably low level, and address them through designing and implementing responses.
3. Quality risks arise from conditions, events, circumstances, actions or inactions associated with the nature and circumstances of the firm and the engagements it performs, including the types of entities for whom such engagements are undertaken. These factors also influence the nature, timing and extent of the responses that are designed to address the quality risks. For example:
 - *Nature and circumstances of the firm:* The firm may centralize the performance of certain engagement procedures in a location. This may create, or increase the likelihood of, the quality risks for the appropriate direction and supervision of the engagement team and review of the work performed because the personnel may not be in the same location as the engagement partner or the engagement team. This may also affect the nature and extent of the firm's response to the quality risks, for example, the firm may develop technology to facilitate interaction between the engagement partner and personnel located in the central location, to support appropriate direction and supervision.
 - *The engagements performed by the firm, including the types of entities for whom engagements are undertaken:* The firm may only perform related services engagements and because of the nature of such engagements, the assessment of the quality risk that the firm does not have the intellectual resources to support the consistent performance of engagements may be low. This may also affect the nature of the firm's response to the quality risks, for example, the firm may develop a checklist for the performance of the related services engagements instead of a formal methodology. In relation to the types of entities for whom engagements are undertaken, the firm may perform engagements for entities in a particular industry, such as banks, insurance companies and pension funds. This may increase the likelihood of the quality risks that the human resources do not have the appropriate competence and capabilities to perform the engagement. It may also affect the nature and extent of the firm's response to the quality

¹ International Standard on Auditing (ISA) 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement*

risks, for example, the firm may establish policies or procedures that require the approval of firm leadership to perform engagements in this industry.

4. The firm's processes for establishing quality objectives, identifying and assessing quality risks and designing and implementing responses includes considering whether they need to be modified, as appropriate, for changes in the matters described above.

Governance and Leadership

5. The governance and leadership component provides the basis for the system of quality management, because the firm needs to establish structures, reporting lines and appropriate authority and responsibility in order that the other components of the system of quality management can be developed. For example, in order to establish a system of quality management, the firm needs to identify the individual(s) responsible for its development. It also creates the environment in which the other components of the system of quality management operate because it addresses the firm's culture, decision-making process, actions, the assignment of responsibility and how firm leadership obtains and allocates resources. Accordingly, the governance and leadership component has a pervasive effect on the system of quality management and the other components cannot be effective if the environment in which they operate is not appropriate.

Relevant Ethical Requirements

6. The relevant ethical requirements component comprises the firm's processes for managing compliance with relevant ethical requirements, in order that the firm, its personnel and others subject to relevant ethical requirements, as applicable, fulfill the principles of professional ethics. The processes include how the firm responds to breaches of the relevant ethical requirements and the process for identifying, assessing and addressing threats to compliance with the principles of professional ethics. Relevant ethical requirements includes independence.

Acceptance and Continuance of Client Relationships and Specific Engagements

7. The acceptance and continuance of client relationships and specific engagements comprises the firm's processes for consideration of matters in determining whether to accept or continue a client relationship or specific engagement. Such matters include the nature and circumstances of the engagement, the integrity and ethical values of the client, including management, and, when appropriate, those charged with governance and the firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements.

Resources

8. The resources component comprises the firm's processes for obtaining, developing, using, maintaining and allocating resources to support the design, implementation and operation of the system of quality management. The resources relevant to the firm's system of quality management include human resources, technological resources and intellectual resources. Furthermore, financial resources are needed for obtaining, developing and maintaining the other types of resources. The firm may have competing priorities that affect the allocation of resources, however firm leadership has a responsibility for obtaining and allocating the resources in a manner that supports the firm's commitment to quality. The anticipation of the firm's resource needs and timely identification of

changes in the factors described in paragraph 3 support the firm in appropriately obtaining, developing and maintaining its resources.

Engagement Performance

9. The engagement performance component comprises the firm's actions to promote and support the appropriate performance of engagements in accordance with professional standards and legal and regulatory requirements. This includes how the firm supports engagement teams in making judgments, forming conclusions, and documenting the work performed. Matters addressed in this component include the responsibilities of the engagement team, including in relation to direction, supervision and review, consultation, differences of opinion and the scope of engagements that should be subject to an engagement quality control review.

Information and Communication

10. The information and communication component encompasses the information system established by the firm to obtain, generate or use information that is needed for the other components of the system of quality management to operate. The information system may be manual, enabled by information technology or a combination of both. The information and communication component also includes the processes to communicate information, which involves all personnel who have a responsibility for effective two-way communication in relation to their roles and responsibilities.
11. External communication with stakeholders may be necessary to support the functioning of the system of quality management, for example, communication with external oversight authorities regarding the results of external inspections or communication with those charged with governance of the firm's clients regarding matters related to independence. Communication with stakeholders also includes the firm's communication about its system of quality management. Such communication is important for stakeholders' understanding of the firm's activities to address quality through its system of quality management and the effectiveness of the firm's system.

Monitoring and Remediation Process

12. Monitoring comprises the firm's processes for evaluating the design, implementation and operation of the system of quality management. It involves undertaking ongoing and periodic monitoring activities of the components of the system of quality management, and based on those findings, identifying whether there are deficiencies in the system of quality management. Deficiencies in the system of quality management may also be identified from other information sources, for example, the results of external inspections or through the firm's complaints and allegations process. In order to understand how the deficiencies arose, the monitoring process includes undertaking a root cause analysis of all deficiencies, although the extent of procedures in undertaking the root cause analysis depends on the nature and possible severity of the deficiency.
13. Remediation comprises the firm's actions for responding to identified deficiencies, which includes designing and implementing remedial actions and monitoring those actions to determine whether they appropriately address the deficiency. Remediation may also involve addressing the specific engagement, for example, when the deficiency indicates that the engagement report is inappropriate. Communication of the results of monitoring and remediation within the firm also forms part of the firm's remedial actions, since personnel often need to be aware of the results in order to fulfill their roles and responsibilities.

14. This component also includes the responsibilities of the individual(s) with ultimate responsibility and accountability for the system of quality management to determine whether the system as a whole achieves the objective of this ISQC.

Interrelationship of the Components

15. Within the system of quality management, the components operate in an integrated manner. For example:
 - The firm's risk assessment process is the process used to establish quality objectives, identify and assess quality risks and design and implement responses for the other seven components of the system of quality management.
 - The governance and leadership component creates the environment in which the other components operate, as explained in paragraph 5.
 - The information and communication component provides the information system that generates the information needed by the other components in order that they can properly function.
 - The monitoring and remediation process monitors the system of quality management, through monitoring activities undertaken over the other components of the system of quality management, and remediates identified deficiencies.

There are also connections amongst the other components, for example, certain quality objectives within the relevant ethical requirements component may be considered when accepting or continuing client relationships and specific engagements. Furthermore, the firm's decisions about one component may affect the quality risks and responses of another component, for example, the firm's decisions about the extent of human resources it obtains may affect the quality risks and responses regarding engagement acceptance and continuance.