

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

### Objective of the IAASB discussion

The objective of this Agenda Item is to obtain the IAASB's input on the following matters relating to Proposed ISQC 1 (Revised):

- Revisions to the introduction to explain the system of quality management (SOQM) and the concept of professional judgment in the context of a SOQM.
- The overall structure of the standard, including the ordering of the components within the standard.
- Revisions to the quality risk assessment process (RAP).
- Revisions to the monitoring and remediation process, including the revised structure of this component.

### Introduction

1. This paper should be read in conjunction with **Agenda Item 5–A**, which demonstrates how the Quality Control Task Force (QCTF) intends on including the proposals set out in this paper in proposed ISQC 1 (Revised). **Agenda Item 5–A** includes the marked changes from the March 2018 version of proposed ISQC 1 (Revised) and **Agenda Item 5–C** is the clean version. Therefore, references to **Agenda Item 5–A** in this paper are also relevant to **Agenda Item 5–C**. **Agenda Item 5–B** includes the draft appendix of proposed ISQC 1 (Revised), and has been provided for additional context when considering the structure and introductory section of proposed ISQC 1 (Revised). At this stage, the QCTF is not seeking specific feedback on the appendix.
2. The various sections of this paper include a summary of the matters discussed by the IAASB at the March 2018 meeting, to the extent that they relate to the topics being addressed in this paper. The remaining matters raised by the IAASB in March 2018 will be discussed with the IAASB at the September 2018 meeting, where the exposure draft of proposed ISQC 1 (Revised) will be presented for approval. Furthermore, the QCTF plans to discuss the topics of networks and service providers, as well as the definition of relevant ethical requirements, with the IAASB at an upcoming teleconference in July 2018. Appendix 1 includes the QCTF activities since March 2018.

### Outreach Activities

3. Since the March 2018 meeting, the QCTF has undertaken outreach with various stakeholders in order to obtain practical perspectives on the proposals set out in the March 2018 draft of proposed ISQC 1 (Revised). This outreach included:
  - (a) A two-day workshop with representatives of the Global Public Policy Committee, that was observed by a representative of the International Forum of Independent Audit Regulators (IFIAR) Standards Coordination Working Group (SCWG), as well as a Public Interest Oversight Board Observer;

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

- (b) A panel discussion at the Forum of Firms meeting;
  - (c) A teleconference with representatives of the IFIAR SCWG;
  - (d) A presentation at the IAASB National Standards Setters meeting;
  - (e) A teleconference with representatives from the public sector; and
  - (f) A webcast to the members, technical advisors and staff of the International Ethics Standards Board for Accountants (IESBA).
4. The feedback from the outreach has been summarized in Appendix 2 to this paper. The feedback from the public sector representatives related to the public sector considerations in the draft of proposed ISQC 1 (Revised), which will be presented in September 2018.

## Introduction of the Standard

### *Summary of March 2018 IAASB Discussions*

5. At the March 2018 meeting, matters discussed by the IAASB included:
- (a) The introductory material and the objective of the standard, with a suggestion to explain in the introductory material the need to comply with the spirit of what the requirements of the standard aim to achieve.
  - (b) How the standard emphasizes the application of professional judgment, with members variously suggesting further emphasis and clarification of this concept, including:
    - (i) Increasing the emphasis on the use of professional judgment on areas where it is important.
    - (ii) Introducing a definition of professional judgment specifically for proposed ISQC 1 (Revised).
    - (iii) Clarifying that professional judgment is applied in relation to the achievement of the objective of the standard.

### *Task Force Views*

6. The QCTF has introduced a new paragraph in the introductory section that explains the purpose of proposed ISQC 1 (Revised), as suggested by outreach participants, and emphasizes the ultimate goal of the standard (i.e., to support quality engagements) (see paragraph 2A of **Agenda Item 5–A**). Although this paragraph addresses the comments from the Board and outreach participants for the need to emphasize compliance with the spirit of professional standards, the QCTF had varying views about this description, including:
- (a) Whether the description should refer to the spirit and the letter of professional standards.<sup>2</sup> Some QCTF members were of the view that it is necessary to refer to both, otherwise it may be interpreted that it is appropriate to comply with the objective of what the standard aims to

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<sup>2</sup> Spirit and letter of the law from Wikipedia: The letter of the law versus the spirit of the law is an idiomatic antithesis. When one obeys the letter of the law but not the spirit, one is obeying the literal interpretation of the words (the "letter") of the law, but not necessarily the *intent* of those who wrote the law. Conversely, when one obeys the spirit of the law but not the letter, one is doing what the authors of the law intended, though not necessarily adhering to the literal wording.

achieve rather than the requirements themselves. However, other QCTF members raised concern that referring to the letter of professional standards may be interpreted that the words of the law need to be followed, which may be restrictive and not scalable.

- (b) Whether this term can be translated and understood in other languages.
7. The QCTF has also proposed various changes to the introductory material addressing the application of professional judgment in the context of a SOQM, particularly in the context of the achievement of the objective of the standard (see paragraph 5 of **Agenda Item 5–A**). The QCTF also plans to develop a new definition of professional judgment in the context of a SOQM and is exploring further emphasis on how proposed ISQC 1 (Revised) addresses professional skepticism, which will be presented at the September 2018 meeting. The QCTF will continue to consider how proposed ISQC 1 (Revised) addresses the public interest, particularly given more recent feedback from outreach and recent coordination activities with the IESBA.

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

- 1. The IAASB is asked to share their views regarding:
  - (a) The purpose statement in paragraph 2A of proposed ISQC 1 (Revised), including the appropriateness of referring to the spirit of professional standards.
  - (b) The revisions to the introductory material addressing the role of professional judgment in the context of an SOQM (see paragraph 5 of **Agenda Item 5–A**).

#### **Overall Structure of the Standard**

##### *Summary of March 2018 IAASB Discussions*

8. At the March 2018 meeting, matters discussed by the IAASB included:
- (a) The eight components and the structure of the standard, with general support for the components and their location. The IAASB also recognized the concerns and suggestions of certain IAASB Consultative Advisory Group (CAG) Representatives with respect to the structure of the standard<sup>3</sup> and encouraged the QCTF to further understand their views.
  - (b) The description of the components, with general support for how they are described, but mixed views about where the descriptions should be located in the standard. It was also suggested to include an appendix that further explains the components.
  - (c) The references between the components, including further refining and streamlining these references.

##### *Task Force Views*

9. The QCTF is of the view that the difficulty with the readability and understandability of the standard, as highlighted by some CAG Representatives and outreach participants, is being created by:

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<sup>3</sup> At the March 2018 CAG Meeting, certain CAG Representatives commented that although the concepts of the standard are good, it is difficult to understand because it appears overly complicated and may result in varying interpretations of the standard. An alternative approach was suggested whereby the responses would be established in a manner that is more direct, and the risk identification and assessment would be undertaken after taking into consideration the required responses.

- (a) The placement of governance and leadership as the first component, because:
    - (i) It results in forward cross-referencing, and creates the need for further cross-referencing in the remaining components.
    - (ii) It results in the components being organized in a manner where the process that is applied to the other components is intermingled with the components to which the process is applied (this was noted by outreach participants).
  - (b) A lack of upfront explanation of the components, how they interrelate and how the quality RAP applies to the components.
  - (c) The overall length of the standard, in particular the additional appendix that was included in the March 2018 draft, which also created multiple layers of cross referencing.
  - (d) Complexity in the drafting and language.
10. Accordingly, the QCTF proposes the following to clarify and reduce the complexity of the standard:
- (a) In relation to the structure:
    - (i) Notwithstanding the previous general agreement of the IAASB that governance and leadership should be the first component, placing the quality RAP as the first component in the standard. This is more desirable as it helps to clarify that the process is applied to the other components, removes the need for complex cross referencing, and helps with the understandability of the SOQM.
    - (ii) Placing information and communication before monitoring and remediation. This is desirable since it helps the reader to understand what is in the other components, before considering the information and communication needed to support those components.
  - (b) Explaining the components in the introductory section, describing how they interrelate and how the quality RAP applies to the components (see paragraphs 6–6B of **Agenda Item 5–A**). These have been carefully described to emphasize the interconnectedness of the components, in order to address the concerns from outreach participants that the components seem to create boundaries and may restrict how the firm structures their SOQM.
  - (c) As agreed by the Board, replacing the appendix with material that provides background to the components and their interrelationship (see **Agenda Item 5–B**). Given the inclusion of this new appendix, the component descriptions in paragraph 19 of **Agenda Item 5–A** have been removed to reduce repetitiveness; however, they will remain in the components because they are important for establishing the foundation of what the firm needs to accomplish within each component.
  - (d) Undertaking revisions to improve the clarity and simplicity of the drafting and language. Although some changes have been made to the drafting as presented in **Agenda Item 5–A**, the QCTF plans to undertake further revisions as it finalizes the ED.

11. The revised structure as described above would therefore be as follows:

March 2018 Draft	Proposed new Structure
1. Governance and leadership	1. Firm's risk assessment process
2. Quality risk assessment process	2. Governance and leadership
3. Information and communication	3. Relevant ethical requirements
4. Relevant ethical requirements	4. Acceptance and continuance of client relationships and specific engagements
5. Acceptance and continuance of client relationships and specific engagements	5. Resources
6. Resources	6. Engagement performance
7. Engagement performance	7. Information and communication
8. Monitoring and remediation process	8. Monitoring and remediation process

#### Matters for IAASB Consideration

2. The IAASB is asked to share its views regarding:
  - (a) The proposed reordering of the components in proposed ISQC 1 (Revised).
  - (b) How the quality risk assessment and the components have been described in paragraphs 6–6B of **Agenda Item 5–A**, including whether the interconnectedness of the components is clear.

#### Quality RAP

##### Summary of March 2018 IAASB Discussions

12. At the March 2018 meeting, matters discussed by the IAASB included:
  - (a) The name of the quality risk assessment component.
  - (b) The organization of the requirements for the quality objectives and whether it is expected that firms identify additional or more granular quality objectives.
  - (c) How the magnitude of the effect of a quality risk has been described in the definition of quality risk and the requirements and the process undertaken to identify and assess the quality risks.
  - (d) The need for the firm to proactively respond to changes in the factors that affect the quality objectives, quality risks and responses.
13. The IAASB also discussed reinstating the requirement in paragraph 15 of extant ISQC 1<sup>4</sup> relating to the achievement of the objective of the standard.

<sup>4</sup> ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements and Related Services Engagements*

### Task Force Views

14. Since the March 2018 meeting, some members of the QCTF engaged with certain Representatives of the CAG to further understand their concerns and their proposed alternative structure and approach to proposed ISQC 1 (Revised). These CAG Representatives explained that the manner in which the risk identification and assessment has been described could result in an unlimited number of risks that the firm may need to identify and assess. They further emphasized the need for the standard to clearly indicate the minimum that is expected of firms to support consistent application of the standard, which was also raised by various other CAG Representatives in the March 2018 CAG meeting.

### Quality Objectives

15. Recognizing the call to provide a clearer indication of the minimum, or baseline, requirements that would apply to all firms, as well as the encouragement from the Board to clarify whether the required quality objectives are all-inclusive, the QCTF is of the view that:
  - (a) The prescribed quality objectives are all of the objectives that a firm would ordinarily establish (i.e., it should be made clearer that this is the baseline).
  - (b) There is still a need for the standard to recognize that there may be circumstances when additional or more granular quality objectives should be identified by the firm.
16. Accordingly, the QCTF has proposed reducing the focus on the need for the firm to establish quality objectives based on the firm's circumstances or the engagements it performs, coupled with an increased focus on tailoring the quality risks and responses to the nature and circumstances of the firm (see paragraphs 19A–19C of **Agenda Item 5–A**).
17. The QCTF agreed with the IAASB's suggestion to reinstate the requirement for the firm to take further actions to support the achievement of the objective of the standard if the firm determines that the requirements of the standard are insufficient to achieve the overall objective (see paragraph 18A of **Agenda Item 5–A**). The QCTF noted that if such circumstance should arise, it would likely indicate a gap in the firm's quality objectives, unless the circumstance relates to other requirements in proposed ISQC 1 (Revised) not contained in the components (e.g., networks). Accordingly, this paragraph explicitly requires the firm to consider whether additional, or more granular, quality objectives are needed, which addresses the possibility that there may be circumstances when this is appropriate.

### Quality Risks

18. The QCTF has revised the requirement to identify and assess quality risks as follows:
  - (a) The previous definition of quality risks, which contained the threshold above which quality risks need to be identified, has now been included directly in the requirement. The QCTF is of the view that this change supports an improved understanding of the threshold.
  - (b) The threshold for the identification of quality risks now includes the effect of the quality risks on the achievement of the quality objectives, as recommended by the IAASB. The QCTF is of the view that this threshold should be those quality risks that *would* result in the quality objective not being achieved if they occurred.

- (c) The threshold for the identification of quality risks also more explicitly refers to consideration of the quality risks individually and in combination with other quality risks. This addresses the concerns of some outreach participants that the risk threshold was too high.
  - (d) The requirement has been clarified to indicate that the conditions, events, circumstances, actions or inactions that may cause a quality risk to arise, are related to the nature and circumstances of the firm and the engagements it performs. The QCTF is further of the view that it is important that this step in the risk identification process consider risks that *may* result in the quality objective not being achieved, i.e., these would be further assessed to determine whether they *would* result in the quality objective not being achieved.
  - (e) The requirement to assess the quality risks has been included as part of the process of identifying quality risks. This is because the QCTF is of the view that the purpose of the assessment of the quality risks is to determine whether the quality risks meet the threshold and therefore need to be addressed through responses. The QCTF notes that if the identification of the risk is separated from the assessment of the risk, as was the case in the previous draft presented to the IAASB, it may result in an unlimited number of risks that the firm has to identify and further assess.
19. In considering the CAG Representatives' concerns regarding the risk identification and assessment, the QCTF also contemplated whether the risk identification and assessment would be undertaken at a higher organizational level, or at multiple levels within the firm. Based on the outreach feedback, it appears that the risk identification and assessment would be undertaken at multiple levels within the firm and that the levels at which it is performed depends on how the firm is organized and how operational responsibility is assigned. Outreach participants also explained that the manner in which the risk assessment would be done would vary (e.g., top-down versus bottom-up approach). The QCTF also considered how the COSO Integrated Framework<sup>5</sup> addresses the identification and assessment of risks, and noted that it refers to the identification of risks at all levels of the entity.

#### Responses

20. The QCTF has made various amendments to the requirements addressing responses, in order to improve the emphasis on the need for the responses to appropriately address the nature of the quality risks and the likelihood of them occurring.
21. The QCTF considered the perspectives of the outreach participants that the required responses drive a compliance approach, however the QCTF remains of the view that in order to retain the robustness of the standard, certain responses are necessary. Nevertheless, the QCTF noted that the standard has not been clear that the firm should still tailor the responses required by the standard and this may be contributing to the perceived lack of scalability of the standard. The QCTF plans to clarify the scalability of the required responses but, to do so, requires clarity on whether the firm is expected to identify quality risks for all of the required responses. In other words:
- (a) Is the firm required to identify quality risks for all of the required responses (essentially “backfilling” the quality risks)? In this case, the tailoring of the prescribed responses would be linked to the nature of the quality risks and the likelihood of them occurring, as presented in paragraph 19C(b) of **Agenda Item 5–A**.

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<sup>5</sup> Committee of Sponsoring Organizations of the Treadway Commission (COSO), *Internal Control – Integrated Framework (2013)*

Or

- (b) Is it appropriate for the firm not to have a related quality risk for every required response, i.e., there are some responses that the firm merely implements? In this case, the requirement in paragraph 19C(b) of **Agenda Item 5–A** would be as follows:

19C. The firm shall design and implement responses to the identified quality risks. The responses shall:

...

(b) Irrespective of the identified quality risks, include the responses required by this ISQC, the design of which are:

(i) Responsive to the nature of any related quality risks and the likelihood of them occurring; or

(ii) If not related to a quality risk, tailored to the nature and circumstances of the firm and the engagements it performs.

Title of the Component

22. The QCTF proposes changing the name of this component to “the firm’s risk assessment process” because:
- (a) This is similar to the title that is used in ISA 315 (Revised)<sup>6</sup> and the COSO Integrated Framework. The QCTF is of the view that “firm” is necessary in the component description to differentiate it from the “entity’s risk assessment process” in ISA 315 (Revised). The QCTF notes that this component includes requirements for objective setting, however similar principles exist in the equivalent component in the COSO Integrated Framework which are well understood.
- (b) The QCTF had used the term “quality management process” previously but found that this was causing confusion with the term SOQM, which refers to the system as a whole.

Requirements Addressing the Prescribed Quality Objectives and Responses in the Components

23. Given the various changes outlined above, and the feedback to simplify and streamline the standard, the QCTF has proposed changes to the requirements in the components that address the establishment of the quality objectives, quality risks and responses. This is demonstrated in the governance and leadership component in paragraphs 20–22 of **Agenda Item 5–A**.

**Matters for IAASB Consideration**

3. The IAASB is asked to share their views on the changes proposed in paragraphs 18A–19D of **Agenda Item 5–A**, including whether the IAASB:
- (a) Agrees with the QCTF’s conclusion that the standard should be more explicit that the quality objectives are all-inclusive, and reduce the focus on the need for the firm to identify additional or more granular quality objectives.

<sup>6</sup> Proposed International Standard on Auditing (ISA) 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement*

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| (b) Is of the view that the firm is expected to identify quality risks for all prescribed responses, as explained in paragraph 21. |
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## Monitoring and Remediation Process

### Summary of March 2018 IAASB Discussions

24. At the March 2018 meeting, matters discussed by the IAASB included:
- (a) Applying the quality RAP to the monitoring and remediation component.
  - (b) Undertaking monitoring and remediation over the quality RAP.
  - (c) Addressing quality objectives and quality risks in the context of deficiencies.
  - (d) The use of in-process reviews as monitoring activities.
  - (e) How frequently firm leadership should evaluate whether the SOQM provides the firm with reasonable assurance in accordance with the objective of the standard.

### Task Force Views

25. As requested by the IAASB in March 2018, the QCTF has amended the requirements addressing monitoring and remediation in order to reflect that it is also subject to the firm's RAP. This includes new quality objectives for monitoring and remediation that focus on the output of the process. The QCTF explored structuring this component in a manner similar to the other components, however given the extensive responses in this component, it is proposed that a general requirement be included to address the design and implementation of the required responses that references the required responses in the paragraphs that follow (see paragraph 45 of **Agenda Item 5–A**).
26. The QCTF recognizes the concerns from outreach participants regarding the practicalities of the proposed requirement in paragraph 57 of **Agenda Item 5–A**, in particular the need for a framework to provide consistency in application, the level of understanding of firm leadership of the SOQM, whether the conclusion is for a period or a point in time, and how remediation of the deficiencies is taken into account (see paragraph 27 of Appendix 2). The QCTF has amended this requirement to clarify:
- (a) The frequency with which the evaluation is undertaken, as requested by the IAASB.
  - (b) The information that should be considered by firm leadership in undertaking the evaluation, in order to provide clarity regarding what should be considered such that there is consistent application of the requirement.
27. Other changes that have been proposed to this component include:
- (a) Organizing the content into a more logical order, and refining how the requirements are articulated, where possible.
  - (b) More explicit references to monitoring the firm's RAP, in addition to monitoring activities over the responses. This was in response to Board comments and outreach feedback.
  - (c) Highlighting that monitoring activities should be designed to determine whether the responses that are required to be implemented at the engagement level have been implemented. This amendment addresses:

- (i) Comments from the Board and outreach to address other types of engagement-level reviews that may form part of monitoring activities, including in-flight reviews.
  - (ii) Comments from outreach to clarify what an inspection of completed engagements should address.
  - (d) Adding flexibility to the requirement addressing the objectivity of those performing monitoring activities, in response to feedback that there may be certain monitoring activities undertaken directly by the persons performing the related response, which may be appropriate in some cases.
  - (e) Refinement of the requirements addressing communication, in order to reduce the repetitiveness between the communication requirements in monitoring and remediation and those in information and communication (Note: the information and communication section has not been presented in **Agenda Item 5–A**, however it addresses the nature, timing and extent of communication and applies to all communication across the SOQM, including communication required by other components).
28. The QCTF also plans to enhance or consider the application material in relation to the following matters, which will be presented to the IAASB in September 2018:
- (a) Emphasis on the importance of undertaking monitoring activities that confirm the operation of the SOQM across the whole population subject to monitoring (i.e., not only areas of risk), such that the firm forms an appropriate conclusion on its SOQM.
  - (b) The need to consider all of the monitoring activities in determining the nature, scope and frequency of monitoring activities (e.g., if the firm has undertaken engagement level monitoring through in-flight reviews, it may reduce the extent of inspection of completed engagements).
  - (c) Further clarification on what is considered to be inspection of completed engagements.
  - (d) The cyclical inspection of completed engagements, in particular the suggestion that this should be undertaken every 3 years.
  - (e) Factors to consider in determining whether a finding is a deficiency, investigating the root causes of deficiencies and considering the severity and pervasiveness of deficiencies.

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

- 4. Does the IAASB agree with the revisions to the monitoring and remediation component in paragraphs 44–58 of **Agenda Item 5–A**?
- 5. Do the proposed revisions to paragraph 57 of **Agenda Item 5–A** clarify the expectations of firm leadership in evaluating the SOQM, and are these expectations reasonable in the context of the responsibilities of firm leadership?

## 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 March 2018 IAASB meeting, the QCTF has met once in person and held three teleconferences.

#### **Outreach**

3. The outreach activities have been explained in paragraph 3 of the paper. The QCTF will be discussing the March 2018 draft of proposed ISQC 1 (Revised) with the International Federation of Accountants Small and Medium Sized Practices (SMP) Committee at their upcoming June 2018 meeting.

#### **Coordination with Other IAASB Task Forces and Working Groups and other Standard Setting Boards**

##### *ISA 220<sup>7</sup> Task Force*

4. Since the last IAASB discussion at the March 2018 IAASB meeting, the Chair and staff of the QCTF held a teleconference with the ISA 220 Task Force 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.

##### *IESBA*

5. Since the last IAASB discussion at the March 2018 IAASB meeting, the Chair of the QCTF presented an overview of the proposals on ISQC 1 (Revised) to the IESBA via webcast. Furthermore, the Chair and staff of the QCTF and acting Technical Director held a teleconference with various IESBA members and staff to discuss the IESBA perspectives on the March 2018 draft of proposed ISQC 1 (Revised). The QCTF will consider relevant suggestions from the IESBA as it finalizes the standard. The IESBA plans to provide an update on the coordination activities to their Board at their June 2018 meeting, which will include an overview of the coordination activities and discussions related to ISQC 1.

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<sup>7</sup> ISA 220, *Quality Control for an Audit of Financial Statements*

## Appendix 2

### Summary of Outreach Feedback on Proposed ISQC 1 (Revised)

*Please note: The summary below refers to “participants”, which are views that may have been expressed by a single or multiple participants during the outreach engagement. Furthermore, since the outreach was undertaken in different forums, some of the outreach groups may not have commented on the specific matters below. Accordingly, the summary below should not be taken as indicative of the general view of all outreach participants outlined in this paper.*

#### Overall comments

1. Participants in general commented that the standard is difficult to read and may create difficulties with translation and interpretation. There were also concerns that the standard does not sufficiently address the needs of small and medium sized practices.
2. Participants also highlighted the time that it will take and the increased resources that firms will need to properly implement the standard.

#### Components and Structure

3. Although participants supported the eight components because it highlights areas that need to be addressed by the SOQM, they noted that there is too much focus on the components such that it appears to create boundaries between the components and may restrict how the firm structures its SOQM. It was noted that in practice firms are likely to setup their system taking all of the areas covered by the components into account collectively, rather than component by component.
4. Participants also commented that the nature of the components are a mixture of processes (e.g., the quality RAP) and what is needed to perform an engagement (e.g., resources) and the way the components are structured in the standard is awkward. Participants noted that this may be contributing to the difficulty of the readability of the standard and suggested an alternative structure.

#### Introduction

5. There were varying views across the outreach participant groups about how proposed ISQC 1 (Revised) describes the firm’s responsibility to act in the public interest. Some were of the view that the standard should be more direct that the firm and its personnel *have a responsibility* for acting in the public interest and that the components should directly refer to acting in the public interest, where relevant (e.g., governance and leadership). Others noted that the manner in which the standard describes the legitimate interests of relevant stakeholders is unlikely to be understood and applied consistently in practice. There were also concerns that the focus on public interest may not be relevant to SMPs who do not perform audits of public interest entities or who are not regulated.
6. Participants encouraged further emphasis in the standard on the factors that support the application of professional skepticism.

#### Objective

7. Participants commented on the objective of proposed ISQC 1 (Revised), with some expressing concern that the objective appears compliance-based and should more directly address quality and the need to comply with the spirit and principles of the requirements. However, others supported the

objective, noting the need for the objective to be measurable. It was therefore suggested that the introduction of the standard include a purpose statement to explain the purpose of proposed ISQC 1 (Revised), similar to the manner in which ISA 701<sup>8</sup> explains the purpose of the communication of key audit matters.

8. An outreach participant also commented that all of the objectives appear to be overly focused on outputs, rather than the necessary inputs that are needed for a system to operate.

### **Definitions**

9. Participants questioned the scope of the definition of engagement team, as well as whether the definition of partner excludes other partners in the firm who do not perform engagements.

### **Governance and Leadership**

10. It was noted that this component addresses leadership rather than governance, and therefore the title of the component may be misleading.
11. Participants supported that the person ultimately responsible for the SOQM should be the Chief Executive Officer (or equivalent), however emphasized that this person might not be a professional accountant and that it may be difficult to identify who the person is, for example, in circumstances when the firm has multiple layers within their structures or smaller firms where all of the partners have an equal status. They further noted that the standard could better clarify that there may be individuals who have responsibility for functional areas, which contribute to a shared responsibility for the SOQM. There were also concerns about whether it is reasonable to expect firm leadership to have a detailed understanding of the standard, as contemplated by paragraph 17.
12. Participants supported the focus on financial and operational priorities in the context of quality, however recommended that it be addressed differently because there may not be specific responses a firm can put in place to address these.

### **Quality Risk Assessment Process**

13. Participants shared various perspectives on how the quality RAP would be operationalized in practice, including in the case of a network.
14. In relation to the quality objectives, participants recommended clarifying that addressing the quality objectives results in the achievement of the overall objective of the standard.
15. There were some concerns that the threshold for the identification of quality risks is too high, i.e., it should include risks that may be less likely to occur but may have a significant impact and should factor in the cumulative effect of less significant risks. Participants also commented on the complexity of the drafting of this requirement.
16. Participants commented that the prescribed responses drive a compliance approach and do not promote scalability. They further noted that the responses are confusing as written because they appear to link to the quality objectives rather than the quality risks. Various suggestions were made, such as establishing more granular quality objectives, or retaining the quality objectives as is, but

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<sup>8</sup> ISA 701, Communicating Key Audit Matters in the Independent Auditor's Report

introducing risk factors to address granularity. Participants also encouraged a critical evaluation of whether the prescribed quality objectives represent what is expected that firms demonstrate.

17. In response to the suggestion that the quality risk identification and assessment be undertaken after taking into consideration prescribed responses, participants noted that it could result in gaps in the system and it would cause confusion about the purpose of the responses (i.e., it would result in a mixture of responses that address risks and other responses).

### **Information and communication**

18. Participants suggested the standard better highlight that in order to build confidence and trust, transparency is imperative. However, there were varying views about the proposals addressing external communication, including views that the standard should:
  - (a) Not address this topic at all in order to allow innovation and evolution and because it is not part of the objective of the standard.
  - (b) Address what should be done when the firm communicates, rather than whether the firm communicates, because the need for the communication will be market driven.
  - (c) Better address consistency and comparability.

### **Resources**

19. Participants were in general supportive of the proposals in this component, noting that it will likely improve firm behavior because it addresses areas not currently considered by firms' SOQM. However, they highlighted that this is a particularly difficult area for small and medium sized firms to implement given the shortage of talent and fluctuating client needs. They further discussed the positive impact from a network perspective, because networks are likely to better document the processes around the resources. Participants also highlighted the impact on the firm's monitoring since some resources, such as technological resources, are not currently subject to the firm's monitoring activities.
20. Participants commented on the objectives that require the firm to "anticipate" resource needs, noting that it is not always possible to anticipate or monitor resource needs because changes in resources arise from factors outside of the firm's control. Participants agreed that in making strategic decisions, the firm would anticipate its resource needs, and would implement processes to identify and respond to changes in the resource needs.

### **Monitoring and Remediation**

21. Participants had varying views about whether monitoring and remediation is a separate component, and whether it is a component that is subject to the quality RAP. Participants also observed that the manner in which the requirements are written appears as if the monitoring activities do not cover the quality RAP.
22. In relation to the inspection of completed engagements:
  - (a) Participants noted that there is a general interpretation that the standard effectively requires the cyclical inspection of completed engagements every 3 years, and that this consumes extensive resources that could instead be used to perform alternative, more effective monitoring activities. While participants acknowledged the need for the standard to retain its

robustness, they noted that the 3 year guideline was originally introduced in extant ISQC 1 at a time when inspection of completed engagements was *the only* form of monitoring activities, and that firms and their environments have since evolved.

- (b) Participants asked for clarity on what is considered to be inspection of completed engagements because there are varying interpretations on the extent of the review in practice. Some participants were of the view that it should address areas of critical judgment and be less compliance focused.
23. Participants also discussed the benefit of in-flight reviews as monitoring activities, in particular their preventative nature and that they are often viewed more positively by practitioners as coaching mechanisms. Some participants however viewed these as responses rather than monitoring activities.
24. Participants raised concern that introducing a risk-based approach to monitoring may result in incorrect conclusions on the firm's SOQM because the firm would focus only on areas where errors are expected to occur, which may not be representative of the entire population. As a result, while some monitoring activities may focus on areas of risk, they noted the importance of undertaking monitoring activities that confirm the operation of the system across the population.
25. Participants suggested that a deficiency should not just be at the response level, and should also include quality objectives and quality risks. They further encouraged clarification of the difference between deficiencies and findings and that multiple findings may cumulate to a deficiency.
26. With respect to the root cause analysis, participants suggested introducing requirements for the firm to consider the root causes of good practices and clarifying what is meant by scaling the root cause analysis based on the severity of the deficiency. However, other participants raised concerns that more specific guidance is needed as this may not be commonly understood in practice.
27. Participants acknowledged the importance of leadership taking responsibility for the system, particularly when they are not involved in the daily operations. However, they were of the view that the requirement for leadership to conclude on whether the SOQM provides reasonable assurance is not practical to implement because:
- (a) In order to be able to conclude on whether the SOQM provides reasonable assurance, a detailed framework is needed that can be applied consistently throughout the profession, particularly since the conclusions may be provided publically. Furthermore, reasonable assurance is a complex concept in the context of a SOQM.
  - (b) The person in leadership may be responsible for the system, but is unlikely to have a detailed understanding of the standards in order to be able to make this conclusion.
  - (c) It is not clear whether the conclusion is for a period or a point in time, and ignores the importance of the remediation of the deficiencies, which is part of the SOQM. Furthermore, participants viewed the system as a continual cycle, and that combining an annual requirement with a cyclical approach will be difficult to implement. Participants further highlighted that in the case of a network, it would be difficult to get consensus across the network firms on a suitable annual date.
28. Participants instead suggested that leadership should conclude on whether the firm has complied with the standard, including:

- (a) Whether appropriate remedial action has been taken to address identified deficiencies.
  - (b) Whether matters related to monitoring and remediation have been appropriately communicated, including externally.
29. Participants had mixed views about the need to communicate about the monitoring and remediation externally, with some of the view that this is important, while others questioned how the information would be used, noting that it should be presumed that the firm complies with ISQC 1 because this is indicated in the firm's engagement reports. Participants also discussed providing information about findings and remedial actions and while some supported disclosure of this information others cautioned that it could drive firms to reduce their monitoring activities in order to avoid reporting negative findings and users may not know how to deal with such information.

### **Networks and Service Providers**

30. Participants emphasized the value of networks in supporting the achievement of quality and suggested that proposed ISQC 1 (Revised) better emphasize this value. Some participants were of the view that because networks sell their brand as a consistent level of quality, there should be requirements that address how the network supports the consistent level of quality or requirements that address what the network is required to do when the firm uses the network services. However, other participants highlighted that the standard cannot establish requirements for the network because it is often not a legal entity and is not regulated, and networks are organized differently and support member firms in a variety of ways. Participants noted that the proposed requirements would already incentivize consistency across network firms because of the need for the network to provide information to support the network firms' SOQM.
31. Participants questioned whether it should be further clarified what the firm is expected to do in order to "evaluate and conclude" on the use of the network services. However, other participants raised concern that these requirements appear onerous and seem to imply that another level of assurance is needed over the network services. They suggested that instead of the firm "evaluating and concluding" on the use of the network services, the firm would instead use this information to "determine whether the network services are appropriate for use" in the SOQM.
32. Participants cautioned that any requirements addressing the communication of information to the network about the results of monitoring or inspections would need to focus on the relevance of the information and acknowledge that in some jurisdictions there are confidentiality restrictions associated with such information.