IAASB International Auditing and Assurance Standards Board®

ISQM 1: Overview of Feedback from the Exposure Draft

Presented by:
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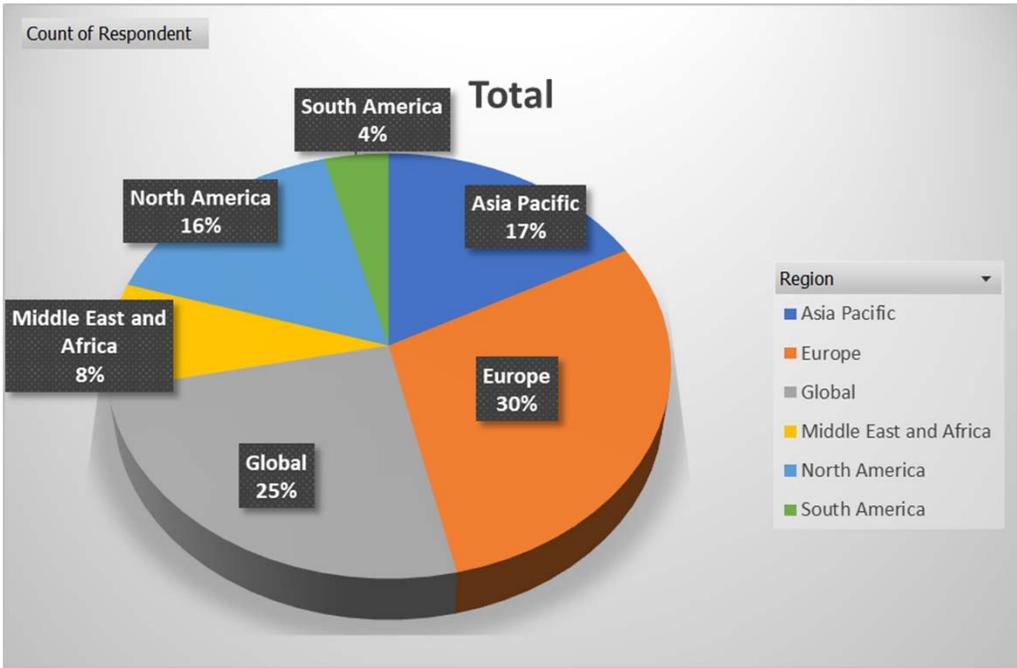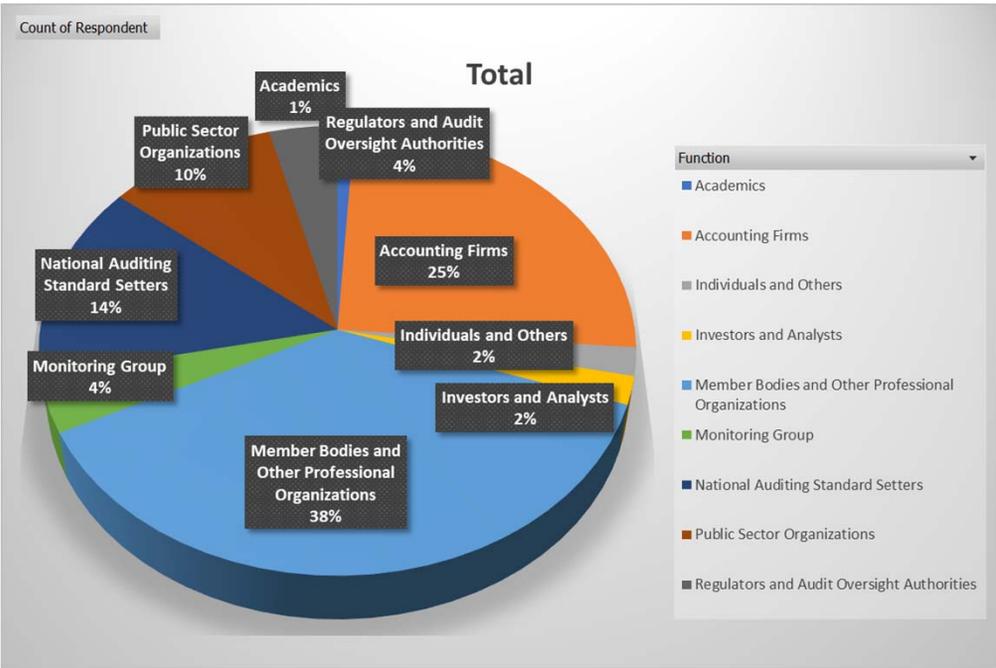
New Quality Management Approach (QMA)

- MG:
  - Enhancements needed to improve proactive and preventative approach
  - Needs to be able to support enforcement

- Other respondents:
  - Positive:
    - Promotes tailored systems and a proactive, integrated and thinking approach to quality management (QM)
    - Will help firms meet challenges facing the profession
  - Concerns:
    - How ED-ISQM 1 incorporates a QMA - hybrid of a risk-based approach and prescriptive requirements
    - Length and complexity of the standard
  - Suggestions included:
    - Reducing prescriptiveness of quality objectives and responses and more explicitly addressing quality risks
    - Restructuring the standard
    - Emphasis on aligning QM with the firm's business strategy and incorporating QM into enterprise risk management

Q1(a) New Quality Management Approach

Disagree

Agree but with further commentary

Agree
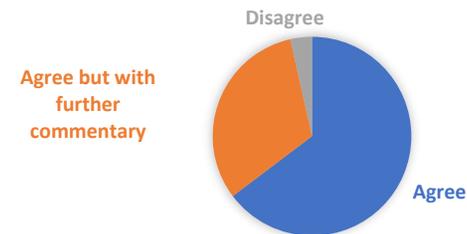
Benefits for Engagement Quality and Professional Skepticism (PS)

- MG:
  - Support how ED-ISQM 1 addresses PS
  - Also address PS in governance and leadership
- Other respondents:
  - SOQM is the foundation for consistently delivering high quality engagements
  - Governance and leadership is critical to embedding and supporting a culture of quality and a focus on professional skepticism
  - Effect of the standard and expected benefits would vary from firm to firm
  - Address PS in other areas of the standard, particularly governance and leadership
  - Concerns:
    - Benefits may be limited for SMPs
    - Prescriptiveness = checklist mindset = unlikely to improve engagement quality
    - Implementing standard will be resource intensive – possible negative effect on engagement quality
    - Cost-benefit analysis needed
    - Extent of documentation needed to demonstrate compliance with the standard

Q1(b) Benefits for Engagement Quality and Professional Skepticism

Disagree

Agree

Agree but with further commentary
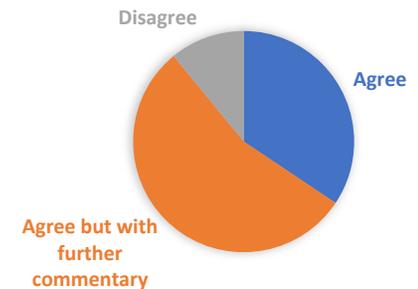
Scalability

- MG:
  - Need for larger firms to scale-up (i.e., additional to what is in the standard)
  - Length of standard and proposed additional guidance – need for a critical review and improved clarity of standard

- Other respondents:
  - Examples and guidance will be needed to demonstrate scalability – however, the need for examples and guidance indicates lack of clarity of standard
  - Concerns:
    - Prescriptiveness of the standard - not scalable, and having required responses with no quality risks indicates approach is not risk-based
    - Length and complexity
    - Threshold for identifying quality risks is too low
    - Documentation burden ("comply or explain")
    - Standard appears written for large firms – bottom-up approach needed
    - Firms that perform non-audit services – increasing trends to perform other engagements instead of audits, wide variance in degree of public interest, ITC addressed audit issues, ED-ISQM 1 very audit focused, ED-ISQM 1 not suitable for firms performing related services engagements

Q1(c) Scalability

Agree

Disagree

Agree but with further commentary
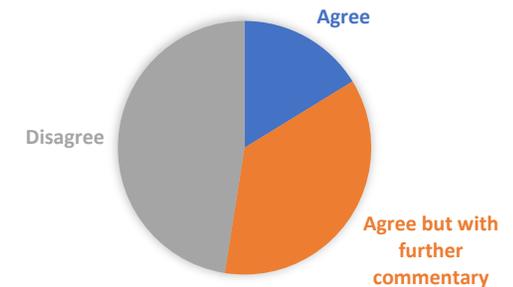
Scalability (continued)

- Suggestions:
  - Separate requirements or standards for managing quality for non-audit engagements or audits of less complex entities
  - Simplify requirements and reduce repetitiveness
  - Use certain explanations and diagrams from the Explanatory Memorandum
  - More clearly signpost paragraphs that address scalability
  - Use the same approach that is being considered in the project on ISA 315 (Revised) (i.e., the what/how/why approach)
  - Place material outside of the standard
 - Digitize the standard

Challenges for Implementation

- Time, resources and expertise to implement the standard
- Firm-wide impact:
    - Need for a firm-wide mindset change, and influences the culture of the firm
    - Organizational restructuring, new IT systems
    - Affects other areas of the firm, e.g., human resources and IT functions
- Professional judgment – differing interpretations and concerns about level of documentation needed
- Firm's risk assessment process (FRAP) – identified as particularly challenging to implement
- Other areas of challenge:
    - Monitoring and remediation (M&R) - root cause analysis, identifying and evaluating findings and deficiencies and firm leadership's annual evaluation of the system of quality management
    - Consistent application for networks – includes challenges around consistency of global standards
    - Documentation – some consider standard too burdensome, others suggesting more clarity needed about what needs to be documented
- Length and complexity of standard – difficult to read and understand
- Strong call for support materials and guidance, including clarity regarding what has changed from extant ISQC 1
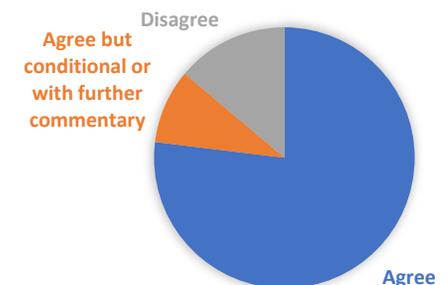
Components and Structure

- Standard has a logical organization and support flexibility of the components

- Concerns and suggestions

  - FRAP should be the first component – helps provide context to standard, even though governance and leadership is very important

    - Also clarifies that FRAP applies to the other components

  - FRAP and M&R are processes in nature and should not be described as components or treated in the same way as other components – "what" is managed vs. "how" it is managed

  - FRAP should not apply to M&R

    - Requirements in M&R already prescriptive – establishing quality objectives and identifying and assessing risks causes circularity

  - Information and communication are necessary for other components to function – should be integrated into the other components
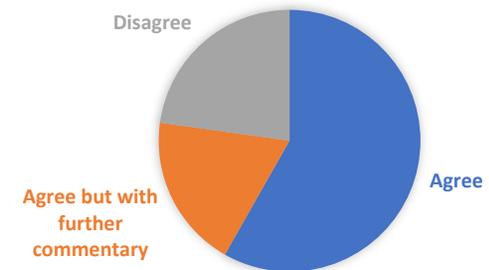
Q4 Components and Structure

Disagree
Agree
Agree but with further commentary
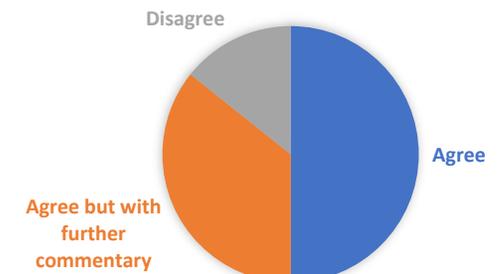
Q6(a) FRAP Applies to Other Components

Disagree
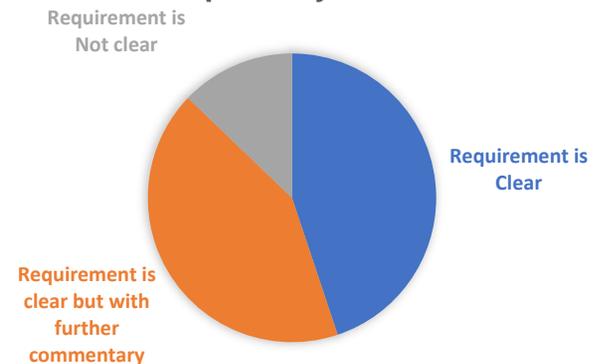Agree but conditional or with further commentary
Agree

Establish Quality Objectives (QO)

- MG:
  - Clarity needed on when and how additional QO should be developed
  - Suggested requirements that support establishing more granular quality objectives to support identifying and assessing quality risks (QR)

- Other respondents:
  - Mixed views
    - QOs are comprehensive, outcome-based and give a steer to firms about the starting point
    - QOs are too prescriptive – should be more high-level and fewer
  - Suggestions included
    - Include specificity of QO in quality risks
    - Clarify circumstances when additional QO should be established
    - More explicit in the standard that additional QO are not always required
    - Change the requirement to "a consideration" of whether additional QO are necessary

Q6(b) & Q6(b)(i) Approach for Establishing Quality Objectives


Disagree · Agree · Agree but with further commentary

Q6(b)(ii) Additional Quality Objectives Beyond Those Required by the Standard

Requirement is Not clear · Requirement is Clear · Requirement is clear but with further commentary

Identify and Assess Quality Risks (QR)

- MG:
  - QR with remote likelihood / significant impact should be considered by firms
  - Other enhancements needed:
    - Assess changes in the external environment and a firm's own business model, need to be dynamic
    - Take findings from regulators into account as part of identifying and assessing QR
- Other respondents:
  - A threshold leads to a consistent approach, standard supports enhanced understanding of QR
  - Concerns about the threshold, i.e., "reasonably possible" and "more than remote"
  - Clarify meaning of "significant effect on the achievement of a QO"
  - Process for identifying and assessing QR overly prescriptive and does not provide flexibility - 2-step process is confusing and overengineered
  - Lack of required QR – illogical
    - Suggestions to repurpose required responses and granularity of QO or provide examples of QR
  - Clarity needed on how to document
 - General need for guidance

Q6(c) Process for the Identification and Assessment of Quality Risks
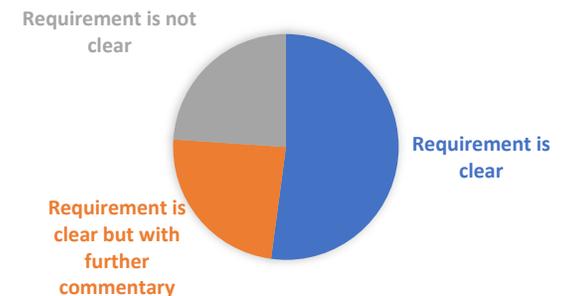
Disagree

Agree

Agree but with further commentary
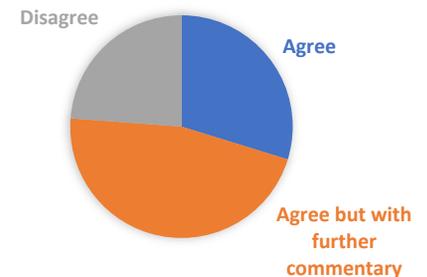
Design and Implement Responses

- MG:
  - Firms may be overly focused on required responses
  - Responses should be more proactive and preventative
- Other respondents:
  - Responses prescriptive = checklist mindset, limited tailoring
  - Firms may "backfill" QR to match responses – perpetuates inappropriate QR
  - Inconsistency in (or lack of) responses across components – appears some components more important than others
  - Firms should not be expected to design and implement additional responses in all circumstances, i.e., responses in the standard may be sufficient
  - Varying views on how to deal with responses
    - Application material vs. requirements
    - Repurpose as QR
    - Other suggestions to clarify requirement to design and implement additional responses

Q6(d) & Q6(d)(i) Approach for Designing and Implementing Responses

Disagree

Agree

Agree but with further commentary
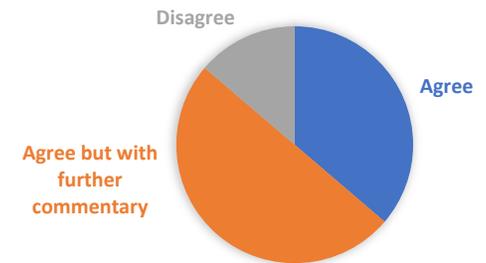
Q6(d)(ii) Requirements to Design and Implement Additional Responses

Requirement is not clear

Requirement is clear

Requirement is clear but with further commentary

Question 1:

Does the IAASB support reordering the standard, including relocating paragraphs 24(a) and 25, as proposed by the ISQM 1 TF?

Question 2:

Does the IAASB support that the firm's risk assessment process and monitoring and remediation processes are "processes"? In particular, does the IAASB agree with:

(a) Introducing new overarching requirements for the firm to establish a risk assessment process / monitoring and remediation process?

(b) Removing the concept that the firm's risk assessment process is applied to the monitoring and remediation process?

Question 3:

Does the IAASB support the conclusion that information and communication should remain a separate component, and that the firm's risk assessment process would continue to apply to information and communication?

Question 4:

Does the IAASB support the proposals to revise the approach to required quality objectives, quality risks and responses in the components by:

(a) Revising the quality objectives to be higher level, which may result in fewer quality objectives;

(b) Introducing quality risk considerations; and

(c) Reducing the required responses?

How the Standard Addresses the FRAP

Question 5:

The IAASB is asked to provide their views on the proposals addressing the requirements for the identification and assessment of quality risks, including whether:

(a) The IAASB supports simplifying the requirements, including condensing the two-step process and addressing the quality risk threshold through the definition of "quality risks" and application material?

(b) Proposed ISQM 1 should retain the concept of "reasonable possibility" in the context of likelihood, or whether another term should be used?

Question 6:

Does the IAASB agree with the suggestion to adjust the requirement to establish additional quality objectives to a "consideration"?

Question 7:

Does the IAASB agree that there is a need to develop separate requirements for firm-level quality management over related service engagements? If so:

(a) Does the IAASB agree that the requirements apply to firms as it relates to their management of quality for related services engagements?

(b) Should the separate requirements be included in:

(i) A separate quality management standard (e.g., ISQM 3)?

(ii) Proposed ISQM 1 as separate requirements?

(iii) The related services standards themselves, i.e., in ISRS 4400 and ISRS 4410 (Revised)?

Question 8:

Does the IAASB support issuing a survey to obtain stakeholder input on the proposed way forward?

Question 9:

Are there other issues arising from the comments on the questions summarized in Section B of this paper (i.e., question 1 and related subquestions, question 2, question 4, and question 6 and related subquestions) that should be considered by the ISQM 1 TF?

Feedback on Other Aspects of ED-ISQM 1: Initial Impressions

- References to the public interest in the standard
  - Support for references, although suggestions to clarify meaning of public interest
- Objective of the standard
  - Support for the objective
  - Additional suggestions include:
    - Incorporating public interest in the objective
    - Adjusting the objective to be more outcome-based
    - Clarifying concept of reasonable assurance in the context of a SOQM
- Governance and leadership
  - Support for the proposals in ED-ISQM 1
  - Concerns about prescriptiveness of requirements and scalability for SMPs – including requirement to assign responsibility for SOQM and aspects of the SOQM and undertaking performance evaluations
  - Clarity needed on certain requirements, e.g., requirement to assign responsibility for SOQM
  - Mixed views regarding the appropriateness of a requirement to assign responsibility for relevant ethical requirements and/or independence

Feedback on Other Aspects of ED-ISQM 1: Initial Impressions (cont.)

- Relevant ethical requirements
  - Strong support for how ED-ISQM 1 addresses network independence
- Resources
  - Support for how ED-ISQM 1 addresses technological resources
  - Suggestions to clarify the scope of technological resources addressed by ED-ISQM 1
  - Calls for additional guidance
- Information and communication
  - Overall mixed views
    - Concerns that requirement is too prescriptive regarding reference to transparency reports (e.g., creates a de facto requirement)
    - Others (incl. investors) suggesting ED-ISQM 1 should do more in addressing external communication
  - Further clarity needed on who external stakeholders may be
- M&R
  - Overall views that will improve robustness of firms' M&R
  - Concerns about scalability of requirements, level of prescriptiveness and whether will drive innovation

- M&R (continued)
  - Mixed views on the requirement addressing inspection of completed engagements
    - Requirement is prescriptive - suggestions that requirement should be more risk-based
    - The "3 year suggestion" in AM is a de facto requirement
    - Discourages or creates barriers to firms developing other monitoring techniques
  - Clarity needed on references to "in-process reviews"
  - Concerns that a lack of clarity of framework for evaluating findings and identifying deficiencies
    - Difference between findings and deficiencies is not clear
    - Consider a concept of "significant deficiencies"
    - Various comments and suggestions on definition of deficiencies
  - Support for new requirement to investigate root causes – further suggestions
    - Clarify the scope of root cause analysis
  - Mixed views about how standard addresses positive findings
  - Clarify the iterative nature of identifying and evaluating deficiencies and undertaking root cause analysis

- M&R (continued)
  - Many challenges identified regarding annual evaluation of SOQM
    - Too onerous for SMPs, suggestions that the evaluation is too frequent
    - Clarity needed on whether it is "a point in time" vs. "a periodic" assessment, including how to consider deficiencies in the process of being remediated
    - Clarity needed on meaning of "reasonable assurance" and how severity of deficiencies affects the evaluation
    - Suggestions that it is a self-evaluation so may not be effective
    - Expectations on an individual may be onerous (also in context of other requirements in the standard)
- Networks
  - Overall support for the requirements proposed in ED-ISQM 1
  - Proposals that firms should determine that network requirements / services are appropriate for use
  - Concerns about challenges in obtaining the information from the network
  - Various comments on information that is to be obtained by the firm about the overall scope and results of the monitoring activities across the network firms' SOQM
  - Respondents seeking guidance on how requirements should be implemented
  - Ad-hoc concerns about whether standard is sufficiently robust to address networks themselves

Feedback on Other Aspects of ED-ISQM 1: Initial Impressions (cont.)

- Service providers
  - Overall support for addressing service providers in the standard
  - Concerns about
    - The scope of service providers
    - Obtaining information from service providers
    - Requirement being too onerous and not practical to implement
  - Respondents seeking guidance on how requirements should be implemented
- Application material
  - More examples needed of how standard is scalable
  - Reduce length of application material
  - Include helpful material from the Explanatory Memorandum
  - Support for additional FAQ and examples
- Strong call for additional support materials and guidance, particularly guidance supporting first time implementation, SMPs, monitoring and remediation, root cause analysis and documentation