Introduction

Scope of this ISQM

1. This International Standard on Quality Management (ISQM) deals with a firm’s responsibilities to design, implement and operate a system of quality management for audits or reviews of financial statements, or other assurance or related services engagements. ISQM 1 deals with the responsibility of the firm and engagement quality reviewers relating to engagement quality reviews that are required to be performed by this ISQM. This ISQM is to be read in conjunction with relevant ethical requirements.

2. Other pronouncements of the International Auditing and Assurance Standards Board (IAASB) include requirements for engagement partners and other personnel regarding quality management at the engagement level. ISA 220 (Revised), for example, deals with the specific responsibilities of the auditor regarding quality management at the engagement level for an audit of financial statements and the related responsibilities of the engagement partner. (Ref: Para. A1)

3. Law, regulation or relevant ethical requirements may establish responsibilities for the firm’s management of quality beyond those described in this ISQM.

4. This ISQM applies to all firms performing audits or reviews of financial statements, or other assurance or related services engagements (i.e., if the firm performs any of these engagements, this ISQM applies).

NOTE: TEXT IN GREY HIGHLIGHT IS NOT FOR DISCUSSION IN DECEMBER 2019 AND HAS NOT YET BEEN CONSIDERED BY THE ISQM 1 TASK FORCE IN THE CONTEXT OF RESPONDENT COMMENTS

CONTENTS

Proposed International Standard on Quality Management (ISQM) 1, Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements, should be read in conjunction with the Preface to the International Quality Management, Auditing, Review, Other Assurance, and Related Services Pronouncements.

1 Proposed ISQM 2, Engagement Quality Reviews

2 Proposed International Standard on Auditing (ISA) 220 (Revised), Quality Management for an Audit of Financial Statements
The Firm’s System of Quality Management

7. The purpose of a system of quality management is to support the consistent performance of quality engagements by providing the firm with reasonable assurance that the objectives of the system, stated in paragraph 18(a) and (b), are achieved. The public interest is served by the consistent performance of quality engagements. Quality engagements are achieved through planning and performing engagements and reporting on them in accordance with professional standards and applicable legal and regulatory requirements. Achieving the objectives of those standards and complying with the requirements of applicable law or regulation involves exercising professional judgment and, when applicable to the type of engagement, exercising professional skepticism. (Ref: Para. A2–A4)

8. A system of quality management is continual and iterative and is responsive to changes in the nature and circumstances of the firm and its engagements. It also does not operate in a linear manner. However, for the purposes of this ISQM, a system of quality management addresses the following eight components: (Ref: Para. A4A–A5)

   (a) The firm’s risk assessment process;
   (b) Governance and leadership;
   (c) Relevant ethical requirements;
   (d) Acceptance and continuance of client relationships and specific engagements;
   (e) Engagement performance;
   (f) Resources;
   (g) Information and communication; and
   (h) The monitoring and remediation process.

9. In the context of this ISQM, it is intended that the components of a system of quality management are interconnected and operate in a coordinated manner such that the quality of engagements is proactively and effectively managed by the firm.

10. The system of quality management is designed to provide reasonable assurance that the objectives of the system are achieved, through fulfilling the requirements of this ISQM, including achieving the quality objectives.

11. This ISQM requires that, at least annually, the individual assigned ultimate responsibility and accountability for the system of quality management evaluates whether the system of quality management provides reasonable assurance that the objectives of the system have been achieved.

13. Other pronouncements of the IAASB, such as ISA 220 (Revised),³ are premised on the basis that the firm is subject to the ISQMs or to national requirements that are at least as demanding.

**Scalability**

13A. This ISQM requires the firm to apply a risk-based approach in the design, implementation and operation of the system of quality management. The risk-based approach is executed through

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³ Proposed ISA 220 (Revised), paragraph 3
proposing the firm’s risk assessment process. As part of this process, the firm is required to take into account quality risk considerations that focus on:

(a) The nature and circumstances of the firm; and
(b) The nature and circumstances of the engagements performed by the firm.

Accordingly, the design of the firm’s system of quality management, in particular the complexity and formality of the system, will vary. For example, a firm that performs different types of engagements for a wide variety of entities, including audits of financial statements of listed entities, will likely need to have a more complex and more formal system of quality management than a firm that performs only reviews of financial statements or compilation engagements.

Networks and Service Providers

14. A firm’s system of quality management may include network requirements or network services in circumstances when the firm belongs to a network, or resources are provided by a service provider. This ISQM includes requirements for firms to evaluate the network requirements or network services, or the resources provided by a service provider, for the purposes of the firm’s system of quality management. Notwithstanding the firm’s compliance with network requirements or use of network services or resources provided by a service provider, the firm remains responsible for its system of quality management.

Authority of this ISQM

16. This ISQM contains the objective of the firm in following this ISQM, and requirements designed to enable the firm to meet that stated objective. In addition, it contains related guidance in the form of application and other explanatory material and introductory material that provides context relevant to a proper understanding of this ISQM, and definitions. (Ref: Para. A6–A9)

Effective Date

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

Objective

18. The objective of the firm is to design, implement and operate a system of quality management for audits or reviews of financial statements, or other assurance or related services engagements performed by the firm, that provides the firm with reasonable assurance that:

(a) The firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements; and

(b) Engagement reports issued by the firm or engagement partners are appropriate in the circumstances.

Definitions

19. In this ISQM, the following terms have the meanings attributed below:

(a) Deficiency in the firm’s system of quality management (referred to as “deficiency” in this ISQM) – This exists when an aspect of the firm’s system of quality management is
absent, inappropriately designed, or not operating effectively. (Ref: Para. A9A–A10, A175)

(b) Engagement documentation – The record of work performed, results obtained, and conclusions the practitioner reached (terms such as “working papers” or “work papers” are sometimes used).

(c) Engagement partner – The partner or other individual, appointed by the firm, who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.

(d) Engagement quality review – An objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon, performed by the engagement quality reviewer and completed on or before the date of the engagement report.

(e) Engagement quality reviewer – A partner, other individual in the firm, or an external individual appointed by the firm to perform the engagement quality review.

(f) Engagement team – All partners and staff performing the engagement, and any other individuals who perform procedures on the engagement, including individuals engaged by the firm or a network firm. The engagement team excludes an external expert engaged by the firm or by a network firm, and also excludes individuals within the client’s internal audit function who provide direct assistance on an audit engagement when the external auditor complies with the requirements of ISA 610 (Revised 2013).

(g) External inspections – Inspections or investigations undertaken by an external oversight authority related to the firm’s system of quality management or engagements performed by the firm. (Ref: Para. A11)

(gA) Findings – Information accumulated from the performance of monitoring activities or derived from other information sources, including the results of external inspection, which indicates that one or more deficiencies may exist. (Ref: Para. A11A)

(h) Firm – A sole practitioner, partnership or corporation or other entity of professional accountants, or public sector equivalent. (Ref: Para. A12)

(i) Listed entity – An entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body.

(j) Network firm – A firm or entity that belongs to a network.

(k) Network – A larger structure: (Ref: Para. A13–A14)

(i) That is aimed at cooperation, and

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

5 ISA 610 (Revised 2013), Using the Work of Internal Auditors, establishes limits on the use of direct assistance. It also acknowledges that the external auditor may be prohibited by law or regulation from obtaining direct assistance from internal auditors. Therefore, the use of direct assistances is restricted to situations where it is permitted.

6 As defined in the International Ethics Standards Board for Accountants’ International Code of Ethics for Professional Accountants (including International Independence Standards) (IESBA Code)
(ii) That is clearly aimed at profit or cost-sharing or shares common ownership, control or management, common quality management policies or procedures, common business strategy, the use of a common brand name, or a significant part of professional resources.

(l) Partner – Any individual with authority to bind the firm with respect to the performance of a professional services engagement.

(m) Personnel – Partners and staff.

(n) Professional judgment – The application of relevant training, knowledge and experience, within the context of professional standards, in making informed decisions about the courses of action that are appropriate in the design, implementation and operation of the firm’s system of quality management.

(o) Professional standards – IAASB Engagement Standards, as defined in the IAASB’s Preface to the International Quality Management, Auditing, Review, Other Assurance and Related Services Pronouncements, and relevant ethical requirements.

(p) Quality objectives – The desired outcomes in relation to the components of the system of quality management that are required to be achieved by the firm.

(q) Quality risks – Risks arising from conditions, events, circumstances, actions or inactions that could, individually or in combination with other quality risks, adversely affect the achievement of a quality objective(s). (Ref: Para. A14A)

(qA) Quality risk considerations – Factors that are indicative of, or that affect, the conditions, events, circumstances, actions or inactions that may give rise to quality risks and affect the assessment of the quality risks.

(r) Reasonable assurance – In the context of the ISQMs, a high, but not absolute, level of assurance.

(s) Relevant ethical requirements – Principles of professional ethics and ethical requirements that are applicable to professional accountants when undertaking engagements that are audits or reviews of financial statements or other assurance or related services engagements. Relevant ethical requirements ordinarily comprise the provisions of the IESBA Code related to audits or reviews of financial statements, or other assurance or related services engagements, together with national requirements that are more restrictive. (Ref: Para. A15–A16, A67)

(t) Response (in relation to a system of quality management) – Policies or procedures designed and implemented by the firm to address an assessed quality risk: (Ref: Para. A17–A18, A24S)

(i) Policies are statements of what should, or should not, be done to address an assessed quality risk. Such statements may be documented, explicitly stated in communications or implied through actions and decisions.

(ii) Procedures are actions to implement policies.

(u) Staff – Professionals, other than partners, including any experts the firm employs.

(v) System of quality management – A system designed, implemented and operated by a firm to provide reasonable assurance that:
(i) The firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements; and

(ii) Engagement reports issued by the firm or engagement partners are appropriate in the circumstances.

Requirements

Applying, and Complying with, Relevant Requirements

20. The individual(s) assigned ultimate responsibility and accountability for the firm’s system of quality management, and the individual(s) assigned operational responsibility for the firm’s system of quality management shall have an understanding of this ISQM, including the application and other explanatory material, to understand the objective of this ISQM and to apply its requirements properly.

21. The firm shall comply with each requirement of this ISQM unless the requirement is not relevant to the firm because of the nature and circumstances of the firm or its engagements. (Ref: Para. A20)

System of Quality Management

22. The firm shall design, implement and operate a system of quality management to achieve the objective of this ISQM. In doing so, the firm shall exercise professional judgment, taking into account the nature and circumstances of the firm and its engagements. The system of quality management includes a governance and leadership component that establishes the environment that supports the operation of the system of quality management, through the firm’s culture, decision-making processes, actions, organizational structure and leadership. (Ref: Para. A23A–A24)

22A. The firm shall: (Ref: Para. A24A–A24B)

(a) Assign ultimate responsibility and accountability for the system of quality management to the firm’s chief executive officer or the firm’s managing partner (or equivalent) or, if appropriate, the firm’s managing board of partners (or equivalent).

(b) Assign operational responsibility for the system of quality management.

(c) Assign the roles in sub-paragraphs (a) and (b), and any other responsibilities for specific aspects of the system of quality management, to individual(s) that have: (Ref: Para. A24C–A24D)

(i) The appropriate experience and knowledge and sufficient time to fulfill their assigned responsibility; and

(ii) An understanding of their assigned responsibility and accountability for such responsibility. (Ref: Para. A24E)

22B. The firm shall determine that the individual(s) assigned operational responsibility for the system of quality management has a direct line of communication to the individual(s) assigned ultimate responsibility and accountability for the system of quality management.

The Firm’s Risk Assessment Process

22C. The firm shall design and implement a risk assessment process to establish quality objectives, identify and assess quality risks to the achievement of the quality objectives and design and implement responses to address the assessed quality risks. (Ref: Para. A24F–A24H)
22D. The firm shall establish the quality objectives specified by this ISQM and any additional quality objectives considered necessary by the firm to achieve the objective of the system of quality management. (Ref: Para. A24I–A24K)

22E. The firm shall identify and assess quality risks to provide a basis for the design and implementation of responses. As part of identifying and assessing quality risks, the firm shall: (Ref: Para.A24L)

(a) Understand the conditions, events, circumstances, actions or inactions that may adversely affect the achievement of its quality objectives;

(b) Take into account the following quality risk considerations: (Ref: Para. A24M–A24P)

   (i) The nature and circumstances of the firm, including:
      a. The complexity and operating characteristics of the firm;
      b. The firm's strategic decisions and actions;
      c. The characteristics and management style of leadership;
      d. Law, regulation, professional standards and the environment in which the firm operates;
      e. In the case of a firm that belongs to a network, the characteristics of the network requirements and network services; and
      f. The nature and extent of any services provided by service providers.

   (ii) The nature and circumstances of the engagements performed by the firm subject to the system of quality management, including:
      a. The types of engagements performed by the firm and the reports to be issued; and
      b. The types of entities for which such engagements are undertaken and the expectations of stakeholders.

(c) Consider the likelihood of the quality risks occurring, and if they were to occur the effect on the achievement of a quality objective(s) before consideration of any response. (Ref: Para. A24Q)

22F. The firm shall design and implement responses to address the assessed quality risks. For this purpose, the firm shall: (Ref: Para. A24R–A24U)

(a) Design the responses in a manner that is based on, and responsive to, the reasons for the assessments given to the quality risks; and

(b) Include the responses specified by this ISQM. The responses specified by this ISQM alone will not be sufficient to achieve the objectives of the system of quality management.

*Modifications to the Quality Objectives, Quality Risks or Responses*

22G. As part of the design and implementation of the firm’s risk assessment process, the firm shall establish policies or procedures to identify information that may indicate changes in the quality risk
considerations or the conditions, events, circumstances, actions or inactions that give rise to the need for modifications to the quality objectives, quality risks or responses. (Ref: Para. A24V–A24W)

22H. The firm shall modify the quality objectives, quality risks or responses, as appropriate, in response to:

(a) Identified changes in the quality risk considerations or the conditions, events, circumstances, actions or inactions; and

(b) Identified deficiencies.

Governance and Leadership

23. The firm shall establish the following quality objectives that address the aspects of the firm’s environment that support the design, implementation and operation of the other components of the system of quality management: (Ref: Para. A35A)

(a) The firm’s culture promotes a commitment to quality, including recognizing and reinforcing: (Ref: Para. A26–A29, A35B)

(i) The firm’s role in serving the public interest by consistently performing quality engagements;

(ii) The importance of professional ethics, values and attitudes;

(iii) The responsibility of all personnel, including their expected behavior, for quality relating to the performance of engagements or activities within the system of quality management; and

(iv) The importance of quality in the firm’s strategic decisions and actions, including the firm’s financial and operational priorities.

(b) The firm holds leadership responsible and accountable for quality. (Ref: Para. A35C)

(c) The firm has an organizational structure with appropriate assignment of roles, responsibilities and authority that supports the firm’s commitment to quality and the design, implementation and operation of the firm’s system of quality management. (Ref: Para. A31)

(d) The firm plans for its resource needs, including financial resources, and obtains, allocates or assigns resources in a manner that supports the firm’s commitment to quality and enables the design, implementation and operation of the firm’s system of quality management. (Ref: Para. A34–A35)

Relevant Ethical Requirements

32. The firm shall establish the following quality objectives that address the fulfillment of responsibilities in accordance with relevant ethical requirements, which, as defined, include the principles of professional ethics: (Ref: Para. A67)

(a) The firm, its personnel and others subject to relevant ethical requirements understand the relevant ethical requirements, including those related to independence.

(b) The firm, its personnel and others subject to relevant ethical requirements fulfill their responsibilities in relation to the relevant ethical requirements, including those related to independence.
(c) The firm, its personnel and others subject to relevant ethical requirements identify and appropriately respond to breaches of the relevant ethical requirements, including those related to independence, in a timely manner.

33. In designing and implementing responses to address the quality risks identified and assessed by the firm relating to the relevant ethical requirements quality objectives, the firm shall include the following responses: (Ref: Para. A68–A69 and A75)

   (a) Identifying the relevant ethical requirements and determining the applicability of the relevant ethical requirements to the firm, its personnel and others, including, as applicable, the network, network firms, personnel in the network or network firms, or service providers. (Ref: Para. A15, A70–A71)

   (b) Establishing policies or procedures that address the identification and evaluation of threats to compliance with the relevant ethical requirements and how identified threats should be addressed. (Ref: Para. A72)

   (c) Establishing policies or procedures that address the identification, communication, evaluation and reporting of breaches and actions to address the causes and consequences of the breaches. (Ref: Para. A73–A74)

   (d) Obtaining, at least annually, a documented confirmation of compliance with independence requirements from all personnel required by relevant ethical requirements to be independent.

Acceptance and Continuance of Client Relationships and Specific Engagements

34. The firm shall establish the following quality objectives that address the acceptance and continuance of client relationships and specific engagements that are appropriate in the circumstances: (Ref: Para. A76)

   (a) The firm obtains sufficient appropriate information about the nature and circumstances of the engagement and the integrity and ethical values of the client (including management, and, when appropriate, those charged with governance) and based on such information makes appropriate judgments about whether to accept or continue a client relationship or specific engagement. (Ref: Para. A77–A82)

   (b) The firm makes appropriate judgments about the firm’s ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements when determining whether to accept or continue a client relationship or specific engagement, including that the firm has: (Ref: Para. A83)

      (i) Resources to perform the engagement; and (Ref: Para. A84)

      (ii) Access to information to perform the engagement, or to the persons who provide such information.

   (c) The firm’s financial and operational priorities do not lead to inappropriate judgments about whether to accept or continue a client relationship or specific engagement. (Ref: Para. A85–A86)

   (d) The firm responds appropriately in circumstances when the firm becomes aware of information subsequent to accepting or continuing a client relationship or specific engagement that would have caused it to decline the client relationship or specific engagement had that information
been known prior to accepting or continuing the client relationship or specific engagement. (Ref: Para. A87–A88)

35. In designing and implementing responses to address the quality risks identified and assessed by the firm relating to the acceptance and continuance quality objectives, the firm shall include policies or procedures that address circumstances when the firm is obligated by law or regulation to accept the client relationship or specific engagement, if applicable. (Ref: Para. A89–A90)

Engagement Performance

36. The firm shall establish the following quality objectives that address the performance of quality engagements: (Ref: Para. A112A)

(a) Engagement teams understand and fulfill their responsibilities in connection with the engagements, including, as applicable:

(i) The engagement partner’s overall responsibility for managing and achieving quality on the engagement and for being sufficiently and appropriately involved throughout the engagement; and (Ref: Para. A91)

(ii) The nature, timing and extent of direction and supervision of the engagement team and review of the work performed. (Ref: Para. A92)

(b) Engagement teams exercise appropriate professional judgment and, when applicable to the type of engagement, professional skepticism. (Ref: Para. A96)

(c) Consultation on difficult or contentious matters is undertaken and the conclusions agreed are implemented. (Ref: Para. A98–A99A)

(d) Differences of opinion within the engagement team, or between the engagement team and the engagement quality reviewer or personnel performing activities within the firm’s system of quality management are brought to the attention of the firm and resolved. (Ref: Para. A100)

(e) Engagement documentation is assembled on a timely basis after the date of the engagement report, and is appropriately maintained and retained to meet the needs of the firm and comply with law, regulation, relevant ethical requirements, or other professional standards. (Ref: Para. A108–A111)

Resources

38. The firm shall establish the following quality objectives that address appropriately obtaining, developing, using, maintaining, allocating and assigning resources, including human resources, technological resources, and intellectual resources, in a timely manner to enable the design, implementation and operation of the system of quality management: (Ref: Para. A113–A116)

(a) The firm hires, develops and retains personnel, including engagement partners, who have the competence and capabilities to: (Ref: Para. A117–A119)

(i) Consistently perform quality engagements, including knowledge or experience regarding professional standards and applicable law or regulation relevant to the engagements the firm performs; or

(ii) Perform activities or carry out responsibilities in relation to the operation of the firm’s system of quality management.
(b) The firm assigns an engagement partner and other human resources to each engagement who have appropriate competence and capabilities, including being given sufficient time, to consistently perform quality engagements. (Ref: Para. A120)

(c) The firm assigns human resources to perform activities within the system of quality management who have appropriate competence and capabilities, including sufficient time, to perform such activities. (Ref: Para. A120)

(d) Personnel demonstrate a commitment to quality through their actions and behaviors, develop and maintain the appropriate competence to perform their roles, and are held accountable through timely evaluations, compensation, promotion and other incentives. (Ref: Para. A121–A123)

(e) The firm obtains or develops, implements and maintains appropriate technological resources to enable the operation of the firm’s system of quality management and the performance of engagements. (Ref: Para. A124–A131)

(f) The firm obtains or develops, implements and maintains appropriate intellectual resources to enable the consistent performance of quality engagements, and such intellectual resources are consistent with professional standards and applicable legal and regulatory requirements, where applicable. (Ref: Para. A132–A133)

(g) Personnel appropriately use the firm’s technological and intellectual resources. (Ref: Para. A134)

39. The firm shall design and implement responses to address the quality risks identified and assessed by the firm relating to the resources quality objectives.

Information and Communication

40. The firm shall establish the following quality objectives that address obtaining, generating or using information regarding the system of quality management, and communicating information within the firm and to external parties on a timely basis to enable the design, implementation and operation of the system of quality management: (Ref: Para. A135)

(a) The firm has an information system that supports the system of quality management by identifying, capturing, processing and maintaining relevant and reliable information, whether from internal or external sources. (Ref: Para. A136–A138)

(b) The firm communicates relevant and reliable information to personnel, the nature, timing and extent of which is sufficient to enable personnel to understand and carry out their responsibilities relating to the performance of engagements or activities within the system of quality management. (Ref: Para. A139)

(c) The firm’s culture promotes and emphasizes the responsibility of personnel to exchange information with the firm and with one another. (Ref: Para. A139)

(d) Personnel communicate relevant and reliable information to the firm when performing engagements or activities within the system of quality management. (Ref: Para. A139)

(e) The firm communicates relevant and reliable information to external parties regarding the firm’s system of quality management, as the firm determines appropriate. (Ref: Para. A142–A153)
41. In designing and implementing responses to address the quality risks identified and assessed by the firm relating to the information and communication quality objectives, the firm shall include the following responses:

(a) Establishing policies or procedures that address the nature, timing and extent of communication and matters to be communicated by the firm with engagement teams. (Ref: Para. A140)

(b) Communicating the responsibility for implementing the firm’s responses to relevant personnel, including engagement teams. (Ref: Para. A141)

(c) Establishing policies or procedures that address the nature, timing and extent of communication and matters to be communicated with external parties, including:

(i) Communication to external parties in accordance with law, regulation or professional standards. (Ref: Para. A142)

(ii) Communication with the network. (Ref: Para. A143)

(iii) Communication with service providers. (Ref: Para. A144)

(iv) Other communication to external parties about the firm’s system of quality management, in a transparency report or otherwise, when the firm determines it appropriate to do so, taking into account: (Ref: Para. A145, A149–A153)

a. Whether there are external parties who may use such information to support their understanding of the quality of the engagements performed by the firm; and (Ref: Para. A146–A147)

b. The nature and circumstances of the firm, including the nature of the firm’s operating environment. (Ref: Para. A148)

Specified Responses

41A. In designing and implementing responses, the firm shall, at a minimum, include the following specific responses: (Ref: Para. A153A)

(a) The firm assigns operational responsibility for compliance with independence requirements to an individual(s) in accordance with paragraph 22A. (Ref: Para. A153B)

(b) The firm establishes policies or procedures for receiving, investigating and resolving complaints and allegations about the commitment to quality of the firm or its personnel. (Ref: Para. A153C–A153D)

(c) The firm establishes policies or procedures addressing engagement quality reviews in accordance with ISQM 2, and that require an engagement quality review for: (Ref: Para. A101–A107)

(i) Audits of financial statements of listed entities;

(ii) Audits of financial statements of entities that the firm determines are of significant public interest; and

(iii) Audits or other engagements for which:

a. An engagement quality review is required by law or regulation; or
b. The firm determines that an engagement quality review is an appropriate response to assessed quality risks, based on the reasons for the assessments given to those risks.

[Other responses to be added when the remaining components that have not been updated in this draft are considered by the ISQM 1 TF, i.e., relevant ethical requirements, acceptance and continuance of client relationships and specific engagements, resources and information and communication]

Monitoring and Remediation Process

42. The firm shall establish a monitoring and remediation process to:

(a) Provide relevant, reliable and timely information about the design, implementation and operation of the system of quality management.

(b) Take appropriate actions to respond to identified deficiencies such that deficiencies are remediated on a timely basis.

43. The firm shall assign operational responsibility for the monitoring and remediation process to an individual(s) in accordance with paragraph 22A.

Designing and Performing Monitoring Activities

44. The firm shall design and perform monitoring activities to identify deficiencies that, individually or in aggregate, could result in the system of quality management not providing reasonable assurance that the objectives of the system have been achieved. In determining the nature, timing and extent of the monitoring activities, the firm shall take into account: (Ref: Para. A155–A159)

(a) The reasons for the assessments given to the quality risks, including:

(i) The likelihood of the quality risks occurring and the effect of the quality risks on the achievement of a quality objective(s); and

(ii) The quality risk considerations; (Ref: Para. A159A)

(b) The design of the responses, or for monitoring activities over the firm’s risk assessment process, the design of that process; (Ref: Para. A160–A161)

(c) Changes in the system of quality management. (Ref: Para. A162)

(d) The results of previous monitoring activities, whether previous monitoring activities continue to be relevant in evaluating the firm’s system of quality management and whether remedial actions to address previously identified deficiencies were effective; and (Ref: Para. A163–A164)

(e) Other relevant information, including concerns identified regarding the commitment to quality of the firm or its personnel and information from external inspections. (Ref: Para. A165–A167)

45. The firm’s monitoring activities shall include the inspection of completed engagements. In selecting completed engagements for inspection, the firm shall take into account the nature, timing and extent of other monitoring activities undertaken by the firm and: (Ref: Para. A168–A170)
(a) Determine which engagements should be subject to inspection, taking into account the relevant factors in paragraph 44, including the identified quality risks as a result of the nature and circumstances of the engagements performed by the firm; and

(b) Include the inspection of at least one completed engagement for each engagement partner on a cyclical basis determined by the firm.

46. The firm shall establish policies or procedures that:

(a) Require those performing the monitoring activities to have the competence and capabilities, including sufficient time, to perform the monitoring activities effectively; and

(b) Address the objectivity of the individuals performing the monitoring activities. Such policies or procedures shall prohibit the engagement team members or the engagement quality reviewer of an engagement from performing any inspection of that engagement. (Ref: Para. A171)

Evaluating Findings and Identifying Deficiencies

47. The firm shall establish policies or procedures addressing the evaluation of the findings arising from the monitoring activities, the results of external inspections and other relevant information to determine whether deficiencies exist, including in the monitoring and remediation process. (Ref: Para. A172–A177)

Evaluating Identified Deficiencies

48. The firm shall establish policies or procedures addressing:

(a) The investigation of the root cause(s) of the identified deficiencies, including that the nature, timing and extent of the procedures to be performed to investigate the root cause(s) take into account the nature of the identified deficiencies and their possible severity; and (Ref: Para. A179–A182A)

(b) The evaluation of the severity and pervasiveness of the identified deficiencies, including the effect of the identified deficiencies, individually and in aggregate, on the system of quality management as a whole. (Ref: Para. A183–A183A)

Responding to Identified Deficiencies

49. The firm shall design and implement remedial actions to address identified deficiencies that are responsive to the results of the root cause analysis. (Ref: Para. A184–A184A)

50. The individual(s) assigned operational responsibility for monitoring and remediation shall evaluate whether the remedial actions are appropriately designed to address the identified deficiencies and their related root cause(s) and determine whether they have been implemented. The individual shall also evaluate whether the remedial actions implemented to address previously identified deficiencies are effective. (Ref: Para. A163)

Findings About a Particular Engagement

51. The firm shall respond to circumstances when findings indicate that there is an engagement(s) for which procedures required were omitted during the performance of the engagement(s) or the report issued may be inappropriate. The firm’s response shall include: (Ref: Para. A185)
(a) Taking appropriate action to comply with relevant professional standards and applicable legal and regulatory requirements; and

(b) When the report is considered to be inappropriate, considering the implications and taking appropriate action, including considering whether to obtain legal advice.

**Ongoing Communication Related to Monitoring and Remediation**

52. The individual(s) assigned operational responsibility for the monitoring and remediation process shall communicate on a timely basis to the individual(s) assigned ultimate responsibility and accountability for the system of quality management and the individual(s) assigned operational responsibility for the system of quality management: (Ref: Para. A186)

(a) A description of the monitoring activities performed;

(b) The identified deficiencies, including the severity and pervasiveness of such deficiencies; and

(c) The remedial actions to address the identified deficiencies.

53. The firm shall communicate the matters described in paragraph 52 to personnel to enable personnel to take prompt and appropriate action in accordance with their responsibilities.

54. The firm shall communicate information about the results of the firm’s monitoring and remediation process to external parties on a timely basis, in accordance with paragraph 41(c).

**Network Requirements or Network Services**

58. When the firm operates as part of a network, the firm shall understand, when applicable: (Ref: Para. A192)

(a) The requirements established by the network regarding the firm’s system of quality management, including requirements for the firm to implement or use resources or services designed or otherwise provided by or through the network (i.e., network requirements);

(b) Any services or resources provided by the network that the firm chooses to implement or use in the design, implementation or operation of the firm’s system of quality management (i.e., network services); and

(c) The firm’s responsibilities for any actions that are necessary to implement the network requirements or use network services. (Ref: Para. A194)

The firm remains responsible for its system of quality management, including professional judgments made in the design, implementation and operation of the system of quality management. The firm shall not allow compliance with the network requirements or use of network services to contravene the requirements of this ISQM. (Ref: Para. A13, A195)

59. Based on the understanding, the firm shall:

(a) Determine how the network requirements or network services are relevant to, and are taken into account in, the firm’s system of quality management, including how they are to be implemented; (Ref: Para. A196)

(b) Evaluate whether the network requirements need to be adapted or supplemented by the firm to be appropriate for use in its system of quality management; and (Ref: Para. A197–A198)
Proposed ISQM 1: Draft Extracts to Reflect Proposals in Agenda Item 7 (Clean)
IAASB Main Agenda (December 2019)

(c) Evaluate the appropriateness of the network services, to determine how to adapt or supplement them. (Ref: Para. A198)

Monitoring and Remediation Process

60. In circumstances when the network performs monitoring activities relating to the firm’s system of quality management, the firm shall:
   (a) Determine the effect of the monitoring activities performed by the network on the nature, timing and extent of the firm’s monitoring activities performed in accordance with paragraphs 44–45; (Ref: Para. A199)
   (b) Determine the firm’s responsibilities in relation to the monitoring activities, including any related actions by the firm; and
   (c) As part of evaluating findings and identifying deficiencies in paragraph 47, obtain the results of the monitoring activities from the network in a timely manner. (Ref: Para. A200)

61. The firm shall, at least annually, obtain information from the network about:
   (a) How the network determines that network requirements have been appropriately implemented across the network firms; and
   (b) The overall scope and results of monitoring activities undertaken by the network across the network firms, if applicable. (Ref: Para. A201–A202)

61A. Based on the information obtained in paragraph 61, the firm shall:
   (a) Consider the effect of such information on the nature, timing and extent of the monitoring activities that need to be undertaken by the firm; and
   (b) Communicate the information to personnel such that personnel take prompt and appropriate action in accordance with their responsibilities.

62. If the firm identifies a deficiency in the network requirements or network services, the firm shall: (Ref: Para. A203–A204)
   (a) Communicate to the network relevant information about the identified deficiency;
   (b) Understand the planned remedial actions by the network, including the firm’s responsibilities to implement the remedial actions;
   (c) Understand whether the network’s remedial actions are designed and implemented to address the identified deficiencies and their related root cause(s); and
   (d) Determine the supplementary remedial actions needed by the firm, if any.

Service Providers

64. When the firm intends to obtain or use resources provided by a service provider in its system of quality management, the firm’s responses for resources shall include: (Ref: Para. A205–A207)
   (a) Obtaining an understanding of the service provider, including determining that the reputation, competence and capabilities of the service provider are appropriate in the context of the intended use of the resource; (Ref: Para. A208)
(b) Establishing the nature and scope of the resources provided by the service provider, including the firm’s responsibilities for any actions that are necessary in using the resources; and (Ref: Para. A209)

(c) Determining whether the resource is appropriate for use in the system of quality management in the context of the quality risks identified and assessed by the firm and the reasons for the assessments given to the quality risks, including when changes are made to the resources provided. (Ref: Para. A210)

Notwithstanding the firm’s use of a service provider(s), the firm remains responsible for its system of quality management.

65. As part of evaluating findings and identifying deficiencies in paragraph 47, if the firm identifies deficiencies in the resources provided by the service provider, the firm shall communicate to the service provider relevant information about the identified deficiencies. The firm shall also:

(a) Understand the planned remedial actions by the service provider and consider whether the service provider’s remedial actions are designed and implemented to address the identified deficiencies and their related root cause(s);

(b) Determine the supplementary remedial actions needed by the firm, if any; and

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

Evaluating the System of Quality Management

[Paragraphs 65A–65C to be further considered once Board input has been obtained]

65A. The individual(s) assigned ultimate responsibility and accountability for the system of quality management shall evaluate whether the system of quality management provides reasonable assurance that the objectives of the system of quality management have been achieved. This evaluation shall take into account: (Ref: Para. A210A–A210B)

(a) The severity and pervasiveness of identified deficiencies; and

(b) The evaluation in paragraph 50 regarding whether the remedial actions are appropriately designed to address the identified deficiencies and their related root cause(s), and have been implemented.

65B. The evaluation in paragraph 55 shall be undertaken at least annually, or more frequently when the identified deficiencies are of a severity and pervasiveness that indicate that the system may not be providing reasonable assurance that the objectives of the system have been achieved.

65C. If the evaluation indicates that the system of quality management does not provide reasonable assurance that the objectives of the system have been achieved, the individual(s) assigned ultimate responsibility and accountability for the system of quality management shall:

(a) Take prompt and appropriate action in accordance with their responsibilities; and (Ref: Para. A210C)

(b) Communicate to:

(i) Personnel to the extent that it is relevant to their responsibilities; and
(ii) External parties in accordance with the firm’s policies or procedures required by paragraph 41(c). (Ref: Para. A210D)

65D. The firm shall undertake periodic performance evaluations of the individual(s) assigned ultimate responsibility and accountability for the system of quality management, and the individual(s) assigned operational responsibility for the system of quality management. In doing so, the firm shall take into consideration the outcome of the evaluation of the system of quality management. (Ref: Para. A210E–A210G)

Documentation

66. The firm shall prepare documentation of its system of quality management that is sufficient to: (Ref: Para. A211–A213)

(a) Support a consistent understanding of the system of quality management by personnel, including an understanding of their roles and responsibilities with respect to the firm’s system of quality management;

(b) Support the consistent implementation and operation of the responses; and

(c) Provide evidence of the design, implementation and operation of the responses, such that the firm is able to evaluate the system of quality management.

67. The firm shall prepare documentation that includes: (Ref: Para. A214)

(a) The firm’s quality objectives and assessed quality risks;

(b) A description of the responses and how the firm’s responses address the assessed quality risks; and

(c) Regarding the monitoring and remediation process:
   (i) Evidence of the monitoring activities performed;
   (ii) The evaluation of the findings from the monitoring activities, results of external inspections and other relevant information, including the identified deficiencies and their related root cause(s);
   (iii) Remedial actions to address identified deficiencies and the evaluation of the design and implementation of such remedial actions;
   (iv) Communications about monitoring and remediation; and
   (v) The basis for the evaluation of whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.

68. The firm shall document the matters in paragraph 67 as they relate to network requirements or network services or resources provided by service providers and:

(a) The evaluation of the effect of the network requirements or network services in accordance with paragraph 59 and the conclusions reached.

(b) The firm’s basis for determining that it is appropriate to use the resources from a service provider in its system of quality management.
69. The firm shall establish a period of time for the retention of documentation for the system of quality management that is sufficient to permit those performing monitoring procedures to evaluate the firm’s system of quality management, or for a longer period if required by law or regulation.

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Application and Other Explanatory Material

Scope of this ISQM (Ref: Para. 2)

A1. Other pronouncements of the IAASB, including ISRE 2400 (Revised)\(^7\) and ISAE 3000 (Revised)\(^8\), also establish requirements for the engagement partner for the management of quality at the engagement level.

The Firm’s System of Quality Management (Ref: Para. 7–8)

A2. The IESBA Code contains requirements and application material for professional accountants that enable professional accountants to meet their responsibility to act in the public interest. In the context of engagement performance as described in this ISQM, the consistent performance of quality engagements forms part of the professional accountant’s responsibility to act in the public interest.

A3. Reasonable assurance is obtained when the firm’s system of quality management reduces to an acceptably low level the risk that the objectives stated in paragraph 18(a) and (b) are not achieved. Reasonable assurance is not an absolute level of assurance, because there are inherent limitations of a firm’s system of quality management. Such limitations include that human judgment in decision making can be faulty and that breakdowns in the firm’s system of quality management may occur, for example, due to human error or behavior or failures in the firm’s IT applications.

A4. The nature of the components in this ISQM are as follows:

- The firm’s risk assessment process and monitoring and remediation process are processes established by the firm as part of the system of quality management.
- Governance and leadership establishes the environment in which the system of quality management operates.
- Resources and information and communication enable the operation of all the other components of the system of quality management.
- The remaining components address specific topics that are fundamental for the performance of audits or reviews of financial statements, or other assurance or related services engagements.

A5. The firm may use different terminology or frameworks to describe the components of its system of quality management.

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\(^7\) International Standard on Review Engagements (ISRE) 2400 (Revised), Engagements to Review Historical Financial Statements

\(^8\) International Standard on Assurance Engagements (ISAE) 3000 (Revised), Assurance Engagements Other than Audits or Reviews of Historical Financial Information
Authority of this ISQM (Ref: Para. 16)

A6. The objective of this ISQM provides the context in which the requirements of this ISQM are set, establishes the desired outcome of this ISQM and is intended to assist the firm in understanding what needs to be accomplished and, where necessary, the appropriate means of doing so.

A7. The requirements of this ISQM are expressed using “shall.”

A8. Where necessary, the application and other explanatory material provides further explanation of the requirements and guidance for carrying them out. In particular, it may:

- Explain more precisely what a requirement means or is intended to cover; and
- Include examples that illustrate how the requirements might be applied.

While such guidance does not in itself impose a requirement, it is relevant to the proper application of the requirements. The application and other explanatory material may also provide background information on matters addressed in this ISQM. Where appropriate, additional considerations specific to public sector audit organizations are included within the application and other explanatory material. These additional considerations assist in the application of the requirements in this ISQM. They do not, however, limit or reduce the responsibility of the firm to apply and comply with the requirements in this ISQM.

A9. This ISQM includes, under the heading “Definitions,” a description of the meanings attributed to certain terms for purposes of this ISQM. These definitions are provided to assist in the consistent application and interpretation of this ISQM, and are not intended to override definitions that may be established for other purposes, whether in law, regulation or otherwise. The Glossary of Terms relating to International Standards issued by the IAASB in the Handbook of International Quality Management, Auditing, Review, Other Assurance, and Related Services Pronouncements published by IFAC includes the terms defined in this ISQM. The Glossary of Terms also includes descriptions of other terms found in the ISQMs to assist in common and consistent interpretation and translation.

Definitions

Deficiencies (Ref: Para. 19(a))

A9A. The firm identifies deficiencies through evaluating findings. A deficiency may arise from a finding, or a combination of findings.

A10. Examples of circumstances when an aspect of the firm’s system of quality management is absent, inappropriately designed, or not operating effectively include when:

- The individual(s) assigned ultimate responsibility and accountability for the system of quality management does not appropriately fulfill their responsibilities, including undertaking the annual evaluation of the system of quality management.
- The firm’s risk assessment process:
  - Is not appropriately designed or implemented in a manner that enables the firm to establish quality objectives, identify and assess quality risks and design and implement responses; or
Fails to identify information that indicates a change in the conditions, events, circumstances, actions or inactions that give rise to the need for modifications to the quality objectives, quality risks or responses.

- A quality objective required to achieve the objective of this ISQM is not established. This may also cause a response to not be properly designed or implemented.
- A quality risk has not been appropriately identified or assessed, such that a response that addresses that risk has not been appropriately designed or implemented.
- A response to address an assessed quality risk is not properly designed, implemented or operating effectively, such that a quality objective may not be achieved. A response to address an assessed quality risk is not properly designed when, for example, a response necessary to address an assessed quality risk is absent or a response is not properly designed in a manner that effectively addresses an assessed quality risk.
- The firm’s monitoring and remediation process is not appropriately designed or implemented in a manner that:
  - Provides relevant, reliable and timely information about the design, implementation and operation of the system of quality management.
  - Enables the firm to take appropriate actions to respond to identified deficiencies such that deficiencies are remediated on a timely basis.

**External Inspections (Ref: Para. 19(g))**

A11. In some circumstances, an external oversight authority may undertake other types of reviews, for example, reviews of specific areas of focus that contribute to the improvement of engagement quality. Paragraph A165 describes such reviews as part of other relevant information considered by the firm in the monitoring and remediation component.

**Findings (Ref: Para. 19(gA))**

A11A. Findings include engagement-level findings that indicate that an engagement was not performed in accordance with the firm’s policies or procedures.

**Firm (Ref: Para. 19(h))**

A12. The definition of “firm” in relevant ethical requirements may differ from the definition set out in this ISQM.

**Network (Ref: Para. 19(k), 58)**

A13. Networks and the firms within the network may be structured in a variety of ways. In some instances, network firms may provide services (e.g., resources) that are used by the firm in its system of quality management. There may also be circumstances when the network includes other structures or organizations that establish requirements for the firm related to its system of quality management, or provides services. For the purposes of this ISQM, networks and the other firms within the network are external to the firm and any network requirements or network services that are obtained from the network, network firms or another structure or organization in the network are considered “network requirements or network services.” Services used by the firm in the system of quality management
that are obtained from outside of the network, network firms or another structure or organization in
the network are considered services obtained from “service providers.”

A14. The IESBA Code provides guidance in relation to the terms “network” and “network firm.”

Quality Risks (Ref: Para. 19(q))

A14A. For the purposes of this ISQM, a quality risk exists when there is a reasonable possibility of:

- The risk occurring (i.e., its likelihood); and
- The risk adversely affecting the achievement of a quality objective if the risk were to occur (i.e.,
  its magnitude).

Relevant Ethical Requirements (Ref: Para. 19(s), 33(a))

A15. The relevant ethical requirements that are applicable in the context of a system of quality
management may vary, depending on the nature and circumstances of the firm and its engagements.
The term “professional accountant” may be defined in relevant ethical requirements. For example,
the IESBA Code defines the term “professional accountant” and further explains the scope of
provisions in the IESBA Code that apply to individual professional accountants in public practice and
their firms.

A16. The IESBA Code addresses circumstances when law or regulation precludes the professional
accountant from complying with certain parts of the IESBA Code. It further acknowledges that some
jurisdictions might have provisions in law or regulation that differ from or go beyond those set out in
the IESBA Code and that professional accountants in those jurisdictions need to be aware of those
differences and comply with the more stringent provisions, unless prohibited by law or regulation.

Response (Ref: Para. 19(t))

A17. Policies are implemented through the actions of personnel and other individuals whose actions are
subject to the policies, or through their restraint from taking actions that would conflict with the firm’s
policies.

A18. Procedures may be mandated, through formal documentation or other communications, or may result
from behaviors that are not mandated but are rather conditioned by the firm’s culture. Procedures
may be enforced through the actions permitted by IT applications, or other aspects of the firm’s IT
environment.

Applying, and Complying with, Relevant Requirements (Ref: Para. 20–21)

A20. Examples of when a requirement of this ISQM may not be relevant to the firm:

- The firm is a sole practitioner. For example, the requirements addressing the organizational
  structure and assigning roles, responsibilities and authority within the firm, appropriate
direction, supervision and review and addressing differences of opinion may not be relevant.
- The firm only performs engagements that are related services engagements. For example, if
  the firm is not required to maintain independence for the related services engagements, the
  requirement to obtain a documented confirmation of compliance with independence
  requirements from all personnel would not be relevant.
System of Quality Management (Ref: Para. 22–22B)

*Design, Implement and Operate a System of Quality Management*

A23A. Quality management is not a separate function of the firm; it is the integration of a quality culture and policies or procedures into the firm’s operational activities and processes with the purpose of actively managing quality. As a result, designing the system of quality management and the firm’s operational activities and processes in a unified manner may promote a harmonious approach to managing the firm, and enhance the effectiveness of quality management.

A24. The quality of professional judgments exercised by the firm is likely to be enhanced when personnel making such judgments demonstrate an attitude that includes a questioning mind, critical assessment of information in formulating decisions, and being alert to changes in the nature and circumstances of the firm or its engagements.

Authorities and Responsibilities (Ref: Para. 22A)

A24A. The governance and leadership component includes a quality objective that the firm has an organizational structure with appropriate assignment of roles, responsibilities and authority that supports the firm’s commitment to quality and the design, implementation and operation of the firm’s system of quality management.

A24B. How the firm assigns roles, responsibilities and authority within the firm may vary and law or regulation may impose certain requirements for the firm that affect the leadership and management structure or their assigned responsibilities.

<table>
<thead>
<tr>
<th>Scalability examples to demonstrate how assigning ultimate responsibility and accountability for the system of quality management may differ:</th>
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<tr>
<td>• In a smaller firm, ultimate responsibility and accountability for the system of quality management may be assigned to a single managing partner with sole responsibility for the oversight of the firm. This individual may also assume responsibility for all aspects of the system of quality management, including operational responsibility for the system of quality management, compliance with independence requirements and the monitoring and remediation process.</td>
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<tr>
<td>• In a larger firm, ultimate responsibility and accountability for the system of quality management may be assigned to a chief executive officer (or equivalent) or a managing board of partners (or equivalent). The firm may also have an independent governing body that has non-executive oversight of the firm, and which may comprise external persons.</td>
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A24C. This ISQM also requires the firm to assign operational responsibility for compliance with independence requirements and the monitoring and remediation process.

A24D. An individual assigned operational responsibility for aspects of the system of quality management may further assign specific roles, procedures, tasks or actions to other individuals within the firm.

A24E. Although an individual may be assigned responsibility for a particular aspect of the system of quality management, in order to fulfill their responsibility, the individual may need to understand how their role contributes to the system of quality management as a whole.
The Firm’s Risk Assessment Process (Ref: Para. 22C–22H)

A24F. How the firm designs the firm’s risk assessment process may be affected by the nature and circumstances of the firm, including how the firm is structured and organized. Although this ISQM is organized by components, the firm’s risk assessment process may be undertaken for the system of quality management as a whole.

Scalability examples to demonstrate how the firm’s risk assessment process may be different:

- A smaller firm may have an informal risk assessment process, which is undertaken by the individual assigned operational responsibility for the system of quality management.
- A larger firm may have a more structured and formal risk assessment process, involving multiple individuals throughout the firm. The process may be centralized (e.g., the quality objectives, quality risks and responses are established centrally for all business units, functions and service lines) or decentralized (e.g., the quality objectives, quality risks and responses are established at a business unit, function or service line level, with the outputs combined at the firm level). The firm’s network may also provide the firm with quality objectives, quality risks and responses to be included in the firm’s system of quality management.

A24G. The process of establishing quality objectives, identifying and assessing quality risks and designing and implementing responses is iterative.

Examples of the iterative nature of the firm’s risk assessment process:

- In identifying and assessing quality risks, the firm determines that a quality risk is also relevant to another quality objective(s).
- When designing and implementing responses, the firm determines that a quality risk was not identified and assessed.

A24H. Information sources that enable the firm to establish quality objectives, identify and assess quality risks and design and implement responses form part of the firm’s information and communication component. Information sources that are relevant to the firm’s risk assessment process may be internal or external to the firm and include:

- Information about the quality risk considerations.
- The results of the firm’s monitoring and remediation process (see paragraph 49).
- The results of external inspections.
- Changes in the system of quality management that affect other aspects of the system, for example, changes in the firm’s resources.
- Information about network requirements or network services (see paragraph 58).
- Other information from the firm’s network, including information from the network about the overall scope and results of monitoring activities undertaken by the network across the network firms (see paragraphs 60–61).
Proposed ISQM 1: Draft Extracts to Reflect Proposals in Agenda Item 7 (Clean)
IAASB Main Agenda (December 2019)

• Other external sources, such as regulatory actions and litigation against the firm or other firms in the jurisdiction that may highlight areas for the firm to consider.

Establish Quality Objectives (Ref: Para. 22D)

A24I. Example of circumstances that may give rise to the need for additional quality objectives:

The firm performs assurance engagements in accordance with jurisdictional law or regulation, or the requirements of national professional standards (i.e., the assurance engagements are not within the scope of the IAASB’s professional standards).

A24J. The nature and circumstances of the firm and its engagements may be such that the objectives in this ISQM are complete, such that the firm may not find it necessary to establish additional quality objectives.

A24K. The firm may determine it appropriate to establish sub-objectives to enhance the firm’s identification and assessment of quality risks, and design and implementation of responses.

Identify and Assess Quality Risks (Ref: Para. 22E)

A24L. The identification of quality risks and assessment of quality risks may be undertaken separately or concurrently.

A24M. In understanding how the quality risk factors give rise to conditions, events, circumstances, actions or inactions that may adversely affect the achievement of a quality objective(s), the firm may consider what could go wrong in relation to the quality risk considerations.

A24N. Examples of the quality risk considerations regarding the nature and circumstances of the firm:

- The complexity and operating characteristics of the firm: The size of the firm, the geographical dispersion of the firm, how the firm is structured, the extent to which the firm concentrates or centralizes its processes or activities (e.g., use of service delivery centers), or the characteristics and availability of the firm’s resources.
- The firm’s strategic decisions and actions: Decisions about financial and operational matters, including the firm’s strategic goals.
- The characteristics and management style of leadership: The composition of firm leadership and their tenure, how authority is distributed among leadership, or how leadership motivates and encourages personnel.
- Law, regulation, professional standards and the environment in which the firm operates: Regulations directly relevant to the firm, professional standards, other standards or regulation affecting engagements performed by the firm (e.g., general purpose frameworks for financial reporting commonly used in the jurisdiction), economic stability, social factors, or the general public’s perception of professional accountancy firms (e.g., a general lack of trust arising from recurring audit failures).
- The characteristics of the network requirements and network services: The nature of the network, how the network is organized and the nature and extent of the requirements established by the network or services provided by the network.
• The nature and extent of any services provided by service providers: The nature of such services.

A24O. Examples of the quality risk considerations regarding the nature and circumstances of the engagements performed by the firm:

• The types of engagements performed by the firm and the reports to be issued: The various engagements performed by the firm (i.e., audits or reviews of financial statements, or other assurance or related services engagements) and how the engagement reports may be used by users.

• The types of entities for which such engagements are undertaken and the expectations of stakeholders: The industries in which the entities operate and the nature of their business, the nature of the entities’ shareholding (e.g., owner-managed or listed), the size of the entities or the nature of the entities’ stakeholders.

A24P. Not all of the quality risk considerations are relevant to every quality objective. Furthermore, other quality risk considerations may be relevant to the firm that are indicative of, or that affect, the conditions, events, circumstances, actions or inactions that may give rise to quality risks.

A24Q. The assessment of identified quality risks need not comprise formal ratings or scores.

Examples of factors that may be considered by the firm in assessing the effect of a quality risk on the achievement of a quality objective(s):

• The expected frequency of the quality risk occurring.

• The rate at which the effect of the quality risk would take place, or the amount of time that the firm has to respond to the quality risk.

• The duration of time of the effect of the quality risk after it has occurred.

Design and Implement Responses to Assessed Quality Risks (Ref: Para. 22F)

A24R. The nature, timing and extent of the responses are affected by the reasons for the assessment given to the assessed quality risks, which includes:

• The likelihood of the assessed quality risk occurring.

• The effect of the quality risk on the achievement of a quality objective(s).

• The quality risk considerations that are indicative of, or that affect, the conditions, events, circumstances, actions or inactions that give rise to the assessed quality risks.

Scalability examples to demonstrate how the quality risk considerations may affect the responses:

| As part of the quality risk considerations relating to resources, a firm determines that the types of entities for which the firm performs engagements includes audits of financial | The response may include specific training and certification for personnel assigned to these engagements. |
statements of listed entities. This gives rise to quality risks that personnel lack the appropriate knowledge and experience of relevant listing requirements to perform the engagement.

As part of the quality risk considerations relating to culture, a firm determines that the firm is small and only has one location, and leadership is concentrated to a single individual. This gives rise to a quality risk that the daily actions and behaviors of leadership have a significant effect on the firm’s culture.

The response may include ongoing independent coaching of firm leadership, including periodically soliciting anonymous feedback from all levels within the firm, so that there is a clear understanding of how leadership’s actions and behaviors are affecting the firm, and how they may be improved to achieve the desired culture.

As part of the quality risk considerations relating to culture, a firm determines that it is large with multiple locations, and there are multiple layers within the leadership structure. This gives rise to various quality risks, including that a consistent culture is not permeated throughout the firm.

The response may include multiple actions, including establishing firm values in a code of conduct, undertaking firm-wide formal communications that emphasize the importance of quality and regular leadership meetings that discuss key messages, decisions and actions.

Example of a response that operates at the firm and engagement level:
The firm establishes policies or procedures setting out specific matters for which consultation by engagement teams is required, and appoints suitably qualified and experienced personnel to provide technical advice to engagement teams. Under the firm’s policies or procedures, the engagement team is responsible for identifying when such matters occur and initiating consultation.

A24S. The responses designed and implemented by the firm may operate at the firm level or engagement level, or there may be a combination of responsibilities for actions to be taken at the firm and engagement level for a response to operate as designed.

A24T. The need for formally documented policies or procedures may be greater for firms that have many personnel or that are geographically dispersed, in order to achieve consistency across the firm.

A24U. The responses required by this ISQM are relevant to every firm’s system of quality management, unless paragraph 21 is relevant.

Modifications to the Quality Objectives, Quality Risks or Responses (Ref: Para. 22G)

A24V. The firm’s information and communication component may already address the identification of changes in the conditions, events, circumstances, actions or inactions that affect the firm’s quality objectives, quality risks or responses, i.e., the policies or procedures may form part of the firm’s information and communication component.

A24W. Changes in the nature and circumstances of the firm’s engagements may affect the design, implementation and operation of the system of quality management.
Example of how a change in the nature and circumstances of the firm’s engagements may affect the design, implementation and operation of the system of quality management:

The firm accepts an engagement to perform an audit of financial statements for an entity involved in an industry for which the firm has not previously performed audit engagements. This gives rise to new quality risks, including that personnel do not have the knowledge or experience relevant to the engagement.

**Governance and Leadership** (Ref: Para. 23)

**Culture** (Ref: Para. 23(a))

A26. The firm’s culture is an important factor in influencing the behavior of personnel. Relevant ethical requirements ordinarily establish the principles of professional ethics, and are further addressed in the relevant ethical requirements component of this ISQM. Professional values and attitudes may include, for example:

- Professional manner, for example, timeliness, courteousness, respect, accountability, responsiveness, and dependability;
- A commitment to teamwork;
- Maintaining an open mind to new ideas or different perspectives in the professional environment;
- Pursuit of excellence;
- A commitment to continual improvement (e.g., setting expectations beyond the minimum requirements and placing a focus on continual learning); and
- Social responsibility.

A29. It is important that the firm’s strategic decision-making process, which may include establishing a business strategy, takes into consideration how the firm’s decisions about financial and operational matters (e.g., the firm’s profitability or strategic focus, such as growth of the firm’s market share, industry specialization or new service offerings) affect the performance of quality engagements.

**Organizational Structure** (Ref: Para. 23(c))

A31. The organizational structure of the firm may include operating units, operational processes, divisions or geographical locations and other structures. In some instances, the firm may concentrate or centralize processes or activities in a service delivery center, for example, engagement teams may include human resources from service delivery centers who perform specific tasks that are repetitive or specialized in nature.

**Resources** (Ref: Para. 23(d))

A34. The individuals(s) assigned ultimate responsibility and accountability or operational responsibility for the system of quality management are in most cases able to influence the nature and extent of resources that the firm obtains, develops, uses and maintains, and how those resources are allocated or assigned, including the timing of when they are used.
A35. Resource needs may change over time, however it may not be practicable to anticipate all resource needs. The firm’s resource planning may involve determining the resources currently required, forecasting the firm’s future resource needs, and establishing processes to deal with unanticipated resource needs when they arise.

Quality Risk Considerations (Ref: Para. 23)-

| A35A. Examples of how the quality risk considerations may give rise to quality risks related to the governance and leadership quality objectives: |
|---|---|
| The firm has a leadership team comprising representatives across the firm’s various business units, including business units who do not perform audits or reviews of financial statements, or other assurance or related services engagements (characteristics of management). This gives rise to a quality risk that decisions about financial and operational priorities may not appropriately consider the importance of quality in performing engagements. | The responses may include appointing an independent governing board to oversee decisions made by firm leadership that may impact the quality of engagements. |
| The firm is a small firm (operating characteristics of the firm) with a few engagement partners who have been partners of the firm for many years (characteristics of management). This gives rise to a quality risk that actions and behaviors of leadership that do not promote quality are not challenged. | The responses may include establishing policies or procedures for receiving, investigating and resolving complaints and allegations about the commitment to quality. The policies or procedures may further specify how complaints and allegations regarding leadership should be addressed. |
| The firm is a large firm (operating characteristics of the firm) and is subject to a jurisdictional audit firm governance code (law, regulation and the environment in which the firm operates). This gives rise to a quality risk that the firm does not fulfill the requirements of the firm governance code as they relate to the firm’s culture, decision-making process, actions, organizational structure and leadership. | The responses may include assigning responsibility to an individual to proactively monitor the firm’s compliance with the jurisdictional audit firm governance code. |
| The firm is a small firm (operating characteristics of the firm) with a few engagement partners with shared authority (the characteristics of management). This gives rise to a quality risk that, given the shared authority, there is a lack of clarity regarding responsibility and accountability. | The responses may include:
- A formal agreement regarding who is responsible and accountable for quality and, if it is assigned to an individual, how the other engagement partners are expected to support that individual; and |
<table>
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<th>Proposed ISQM 1: Draft Extracts to Reflect Proposals in Agenda Item 7 (Clean)</th>
<th>IAASB Main Agenda (December 2019)</th>
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<td><strong>for quality and the individuals are therefore not held responsible and accountable for quality.</strong></td>
<td><strong>Undertaking periodic performance evaluations of the engagement partners to determine whether they have fulfilled their roles in accordance with the agreement.</strong></td>
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<tr>
<th><strong>The firm has a strategic goal to develop and grow a new service line focused on performing compilations of financial statements (the firm’s strategic decisions and actions). This gives rise to a quality risk that the firm’s growth outpaces its ability to obtain resources, placing increased pressure on the allocation or assignment of resources to support the performance of quality engagements.</strong></th>
<th><strong>The responses may include:</strong></th>
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<td><strong>The firm is a small firm with limited resources (operating characteristics of the firm) and operates in an environment where there is high competition for appropriately qualified personnel (the environment in which the firm operates). This gives rise to a quality risk that the firm is unable to respond in a timely manner to unexpected changes in resource needs.</strong></td>
<td><strong>The responses may include:</strong></td>
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### Responses (Ref: Para. 23)-

A35B. The responses designed and implemented by the firm to embed a culture that promotes a commitment to quality are likely to include, among other actions:

- Establishing a tone at the top that emphasizes the importance of quality, through the actions and behaviors of leadership; and
- Clear, consistent and frequent actions and communications at all levels within the firm regarding the importance of quality.

A35C. The responses designed and implemented by the firm to hold leadership responsible and accountable for quality may include undertaking the performance evaluations required by paragraph 65D.

### Relevant Ethical Requirements (Ref: Para. 32–33)

A67. The IESBA Code sets out the fundamental principles of ethics that establish the standard of behavior expected of a professional accountant and establishes the International Independence Standards. The fundamental principles are integrity, objectivity, professional competence and due care, confidentiality and professional behavior. The IESBA Code also specifies the approach that a professional accountant is required to apply to comply with the fundamental principles and the
International Independence Standards and addresses specific topics relevant to complying with the fundamental principles. Law or regulation in a jurisdiction may also contain provisions addressing ethical requirements, including independence, for example, privacy laws affecting the confidentiality of information.

A68. In some cases, the firm may determine that it is appropriate to design and implement responses that are more specific than the provisions of relevant ethical requirements. For example, having regard to the nature and circumstances of the firm and its engagements, a firm may:

- Prohibit the acceptance of gifts and hospitality from a client, even if the value is trivial and inconsequential.
- Set rotation periods for the engagement partner and other senior personnel for all engagements performed by the firm, including other assurance or related services engagements.

A69. Other components include responses that may affect or relate to the relevant ethical requirements component. For example, the following are examples of responses for information and communication and resources that may address assessed quality risks for relevant ethical requirements:

- Communicating the independence requirements to all personnel and others subject to independence requirements, as applicable.
- Providing training for personnel on relevant ethical requirements.
- Establishing manuals and guides (i.e., intellectual resources) containing the provisions of the relevant ethical requirements and guidance on how they are applied in the circumstances of the firm and the engagements it performs.
- Assigning personnel (i.e., human resources) to manage and monitor compliance with relevant ethical requirements or to provide consultation on matters related to relevant ethical requirements.
- Establishing policies or procedures for personnel to communicate relevant information to appropriate parties within the firm or to the engagement partner related to:
  - Personal or firm situations that may create threats to independence, for example, financial interests, loans, employment relationships or personal appointments.
  - Client engagements, including non-assurance engagements. For example, this may include the scope of services, fees or information about long association.
  - Business relationships.
  - Any breaches of the relevant ethical requirements, including those related to independence.
- Establishing an information system, including through IT applications (i.e., technological resources), to monitor compliance with relevant ethical requirements, including recording and maintaining information about independence.

Furthermore, the individual in the firm assigned operational responsibility for compliance with independence requirements is ordinarily responsible for the oversight of all matters related to independence, including the policies or procedures addressing communication of breaches of
independence requirements and determining that appropriate actions have been taken to address the causes and consequences of the breach.

A70. Various provisions of the relevant ethical requirements may apply only to personnel and not the firm itself. For example, Part 2 of the IESBA Code applies to individuals who are professional accountants in public practice when performing professional activities pursuant to their relationship with the firm. The firm’s system of quality management may need to address personnel’s compliance with such relevant ethical requirements, for example, the firm may need to establish policies or procedures to facilitate personnel’s compliance with Part 2 of the IESBA Code (e.g., policies or procedures addressing section 260 of the IESBA Code regarding non-compliance with laws and regulations).

A71. The applicability of the relevant ethical requirements to others (i.e., the network, network firms, personnel in the network or network firms, or service providers) depends on whether those requirements contain specific provisions addressing others, and how the firm uses others in its system of quality management. For example:

- Relevant ethical requirements may include requirements for independence that apply to network firms or employees of network firms.

- The definition of engagement team under relevant ethical requirement may include any individuals engaged by the firm who perform assurance procedures on the engagement (e.g., a service provider engaged to attend a physical inventory count at a remote location). Accordingly, any requirements of the relevant ethical requirements that apply to the engagement team may also be relevant to such individuals.

- The principle of confidentiality may apply to a network, network firm or service provider, given that they may have access to client information obtained by the firm.

A72. Relevant ethical requirements may contain provisions regarding the identification and evaluation of threats and how they should be addressed. For example, the IESBA Code provides a conceptual framework for this purpose and, in applying the conceptual framework, requires that the firm use the reasonable and informed third party test.

A73. The policies or procedures addressing breaches of the relevant ethical requirements, including those related to independence, may address matters such as:

- The communication of breaches of the relevant ethical requirements to appropriate individual(s) within the firm;

- The evaluation of the significance of a breach and its effect on compliance with relevant ethical requirements;

- The actions to be taken to satisfactorily address the consequences of a breach, including that such actions be taken as soon as practicable;

- Determining whether to report a breach to external parties; and

- Determining the appropriate actions to be taken in relation to the individual(s) responsible for the breach.

A74. Relevant ethical requirements may specify how the firm is required to respond to a breach. The IESBA Code sets out requirements for the firm in the event of a breach of the IESBA Code and includes specific requirements addressing breaches of the International Independence Standards, which includes requirements for communication with external parties.
**Public Sector Considerations**

A75. Statutory measures may provide safeguards for the independence of public sector auditors. However, threats to independence may still exist regardless of any statutory measures designed to protect the firm’s independence that will require an appropriate response by the organization.

**Acceptance and Continuance of Client Relationships and Specific Engagements** (Ref: Para. 34–35)

A76. Other components include responses that may affect or relate to the acceptance and continuance of client relationships and specific engagements component. For example:

- The information necessary to support the firm’s decisions about the acceptance and continuance of client relationships and specific engagements is identified, captured, processed and maintained through the information and communication component, and may include intellectual resources such as databases of client information or access to external information databases.
- The firm may use technological resources in the form of IT applications to facilitate the approval of client relationships or specific engagements at appropriate levels within the firm.
- Governance and leadership addresses the responsibility of the firm with respect to appropriate resource planning and obtaining, allocating or assigning resources.

**The Nature and Circumstances of the Engagement and the Integrity and Ethical Values of the Client** (Ref: Para. 34(a))

A77. The information obtained about the nature and circumstances of the engagement may include:

- The industry of the entity for which the engagement is being undertaken and relevant regulatory factors;
- The nature of the entity, for example, its operations, organizational structure, ownership and governance, its business model and how it is financed; and
- The nature of the underlying subject matter and the criteria to be applied in the preparation of the subject matter information, for example, in the case of integrated reporting, the underlying subject matter may include social, environmental and health and safety information and the criteria may be performance measures established by a recognized body of experts.

A78. In some circumstances the firm may establish policies or procedures that specify, or prohibit, the types of engagements that may be performed by the firm, for example, the firm may prohibit the performance of assurance engagements over a certain subject matter. The policies or procedures may also prohibit the performance of engagements for certain types of entities, for example, the firm may prohibit the performance of engagements in certain industries.

A79. The information obtained to support the firm’s judgments about the integrity and ethical values of the client may include the identity and business reputation of the client’s principal owners, key management, and those charged with its governance. The nature and extent of information obtained may depend on factors such as:

- The nature of the entity for which the engagement is being performed, including the complexity of its ownership and management structure.
- The nature of the client’s operations, including its business practices.
• Information concerning the attitude of the client’s principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.

• Whether the client is aggressively concerned with maintaining the firm’s fees as low as possible.

• Indications of a client-imposed limitation in the scope of work.

• Indications that the client might be involved in money laundering or other criminal activities.

• The reasons for the proposed appointment of the firm and non-reappointment of the previous firm.

• The identity and business reputation of related parties.

A80. The firm may obtain the information from a variety of internal and external sources, for example:

• In the case of an existing client, consideration of matters that have arisen during the current or previous engagements, if applicable, or inquiry of other personnel who have performed other engagements for the client.

• In the case of a new client, inquiry of existing or previous providers of professional accountancy services to the client, in accordance with relevant ethical requirements.

• Discussions with other third parties, such as bankers, legal counsel and industry peers.

• Background searches of relevant databases (which may be intellectual resources). In some cases, the firm may use a service provider to perform the background search.

A81. Information that is obtained during the firm’s acceptance and continuance process about the nature and circumstances of the engagement and the integrity and ethical values of the client’s management, and, when appropriate, those charged with governance is in most cases relevant to the engagement team when planning and performing the engagement. Professional standards may specifically require the engagement team to obtain or consider such information. For example, ISA 220 (Revised)\(^9\) requires the engagement partner to take into account information obtained in the acceptance and continuance process in planning and performing the audit engagement in accordance with the ISAs and complying with the requirements of ISA 220 (Revised).

A82. Professional standards or legal and regulatory requirements may include specific provisions that need to be addressed before accepting or continuing a client relationship or specific engagement and may also require the firm to make inquiries of an existing or predecessor firm when accepting an engagement. For example, when there has been a change of auditors, ISA 300\(^{10}\) requires the auditor, prior to starting an initial audit, to communicate with the predecessor auditor in compliance with relevant ethical requirements. The IESBA Code also includes requirements for the consideration of conflicts of interests in accepting or continuing a client relationship or specific engagement and communication with the existing or predecessor firm when accepting an engagement that is an audit or review of financial statements.

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\(^9\) Proposed ISA 220 (Revised), paragraph 21

\(^{10}\) ISA 300, Planning an Audit of Financial Statements, paragraph 13(b)
The Firm’s Ability to Perform Engagements (Ref: Para. 34(b))

A83. The consideration of whether the firm is able to perform engagements in accordance with professional standards and applicable legal and regulatory requirements includes determining that the firm, its personnel and others are able fulfill their responsibilities in relation to the relevant ethical requirements.

A84. The judgments about whether the firm has the resources to perform the engagement may involve reviewing the specific circumstances of the engagement and considering whether the firm has the resources to perform the engagement within the reporting deadline, including whether there are:

- Human resources with the appropriate competence and capabilities, including sufficient time, to perform the engagement. This includes:
  - Personnel to direct and supervise the engagement and take overall responsibility; and
  - Human resources with knowledge of the relevant industry or the underlying subject matter or criteria to be applied in the preparation of the subject matter information and experience with relevant regulatory or reporting requirements.

- Experts that are available, if needed.

- Engagement quality reviewers who meet the eligibility requirements in ISQM 2, if applicable.

- Technological resources, for example, IT applications that enable the engagement team to perform procedures on the entity’s data.

- Intellectual resources, for example, a methodology, industry or subject matter-specific guides, or access to information sources.

The Firm’s Financial and Operational Priorities (Ref: Para. 34(c))

A85. Financial priorities may focus on the profitability of the firm, and fees obtained for the performance of engagements have an effect on the firm’s financial resources. Operational priorities may include strategic focus areas, such as growth of the firm’s market share, industry specialization or new service offerings. There may be circumstances when the firm is satisfied with the fee quoted for an engagement but, notwithstanding the firm’s operational and financial priorities, it is not appropriate for the firm to accept or continue the engagement or client relationship (e.g., when the client lacks appropriate integrity and ethical values).

A86. There may be other circumstances when the fee quoted for an engagement is not sufficient given the nature and circumstances of the engagement, and it may diminish the firm’s ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements. The IESBA Code addresses fees and other types of remuneration, including circumstances that may create a threat to compliance with the fundamental principle of professional competence and due care if the fee quoted for an engagement is too low.

Information That Becomes Known Subsequent to Accepting or Continuing a Client Relationship or Specific Engagement (Ref: Para. 34(d))

A87. Information that becomes known subsequent to accepting or continuing a client relationship or specific engagement may:

- Have existed at the time of the firm’s decision to accept or continue the client relationship or specific engagement and the firm was not aware of such information; or
Proposed ISQM 1: Draft Extracts to Reflect Proposals in Agenda Item 7 (Clean)
IAASB Main Agenda (December 2019)

A88. The firm’s response to address circumstances when information becomes known subsequent to accepting or continuing a client relationship or specific engagement that may have affected the firm’s decision to accept or continue a client relationship or specific engagement may include policies or procedures that set out the actions to be taken, including:

- Undertaking appropriate consultation within the firm or with legal counsel.
- Considering whether there is a professional, legal or regulatory requirement for the firm to continue the engagement.
- Discussing with the appropriate level of the client’s management and with those charged with governance or the engaging party the appropriate action that the firm might take based on the relevant facts and circumstances, and when it is determined that withdrawal is an appropriate action, informing them of this decision and the reasons for the withdrawal.
- If the firm withdraws from the engagement, considering whether there is a professional, legal or regulatory requirement for the firm to report the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities.
- If the firm does not withdraw from the engagement, considering the effect of the information on the performance of the engagement and the additional actions to be taken by the firm or the engagement partner in managing quality at the engagement level (e.g., assigning more experienced personnel to the engagement, requiring an engagement quality review or increasing the extent and frequency of the engagement partner’s direction and supervision of engagement team members and review of their work).

Circumstances When the Firm is Obligated to Accept or Continue a Client Relationship or Specific Engagement (Ref: Para. 35)

A89. There may be circumstances when the firm is obligated to accept or continue a client relationship or specific engagement. For example, jurisdictional law or regulation may impose an obligation on the firm to accept or continue a client engagement, or in the case of the public sector, the firm may be appointed through statutory provisions. In such circumstances, when the firm becomes aware of information that would otherwise have caused the firm to decline or discontinue the engagement, the firm may design and implement additional responses to address the assessed quality risk(s) arising from the performance of such engagements. For example, the firm may assign more experienced personnel to the engagement or may require that an engagement quality review be performed in respect of the engagement. There may also be actions at the engagement level to manage quality when performing such engagements, for example, increasing the extent and frequency of the

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11 Proposed ISA 220 (Revised), paragraph 22
engagement partner’s direction and supervision of engagement team members and review of their work.

A90. In some circumstances, a threat to the firm’s integrity may arise as a result of being associated with the subject matter of the engagement. Relevant ethical requirements may include requirements addressing circumstances when the firm becomes associated with information that is false or misleading. For example, the IESBA Code contains requirements addressing circumstances when the professional accountant becomes associated with information that contains a materially false or misleading statement, contains statements that have been provided recklessly or omits or obscures required information where such omission or obscurity would be misleading.

**Engagement Performance** (Ref: Para. 36)

A91. ISA 220 (Revised)\(^\text{12}\) requires the engagement partner to take overall responsibility for managing and achieving quality on the audit engagement.

**Direction, Supervision and Review** (Ref: Para. 36(a)(ii))

A92. The responsibilities for direction, supervision and review may address:

- The responsibilities of the engagement partner for appropriate direction and supervision of the engagement team and review of the work performed; and
- The need for the work performed by less experienced members of the engagement team to be directed, supervised and reviewed by more experienced engagement team members.

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<th>Examples of responsibilities for supervision and review:</th>
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<tr>
<td>Examples of responsibilities for supervision include:</td>
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<tr>
<td>- Tracking the progress of the engagement;</td>
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<td>- Considering the competence and capabilities of individual members of the engagement team, whether they have sufficient time to carry out their work, whether they understand their instructions and whether the work is being carried out in accordance with the planned approach to the engagement;</td>
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<td>- Addressing matters arising during the engagement, considering their significance and modifying the planned approach appropriately; and</td>
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<tr>
<td>- Identifying matters for consultation or consideration by more experienced engagement team members during the engagement.</td>
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<th>Examples of responsibilities for review include consideration of whether:</th>
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<td>- The work has been performed in accordance with professional standards and applicable legal and regulatory requirements;</td>
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<td>- Significant matters have been raised for further consideration;</td>
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<td>- Appropriate consultations have been undertaken and the resulting conclusions have been documented and implemented;</td>
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\(^\text{12}\) Proposed ISA 220 (Revised), paragraph 11
• There is a need to revise the nature, timing and extent of work performed;
• The work performed supports the conclusions reached and is appropriately documented;
• The evidence obtained for an assurance engagement is sufficient and appropriate to support the report; and
• The objectives of the engagement procedures have been achieved.

Professional Judgment and Professional Skepticism (Ref: Para. 36(b))

A96. Professional skepticism supports the quality of judgments made on the engagement and, through these judgments, the overall effectiveness of the engagement team in performing the engagement. Other pronouncements of the IAASB may address the exercise of professional judgment or professional skepticism at the engagement level. For example, ISA 220 (Revised)\textsuperscript{13} explains the impediments to the exercise of professional skepticism at the engagement level and actions that the engagement partner may take to deal with such impediments.

Consultation (Ref: Para. 36(c))

A98. Consultation typically involves a discussion at the appropriate professional level, with individuals within or outside the firm who have specialized expertise, on difficult or contentious matters. An environment that reinforces the importance and benefit of consultation and encourages engagement teams to consult may contribute to supporting a firm culture that promotes a commitment to quality.

A99. Difficult or contentious matters on which consultation is needed may either be specified by the firm, or the engagement team may identify matters that require consultation. The responsibilities for consultation may address how conclusions are agreed and implemented.

A99A. ISA 220 (Revised)\textsuperscript{14} includes requirements for the engagement partner related to consultation.

Differences of Opinion (Ref: Para. 36(d))

A100. The firm may encourage that differences of opinion are identified at an early stage. In some circumstances, resolving differences of opinion may be achieved through consulting with another practitioner or firm, or a professional or regulatory body.

Engagement Documentation (Ref: Para. 36(e))

A108. Law or regulation may prescribe the time limits by which the assembly of final engagement files for specific types of engagements is to be completed. Where no such time limits are prescribed in law or regulation, the time limit may be determined by the firm. In the case of an audit of financial statements, for example, such a time limit would ordinarily not be more than 60 days after the date of the auditor’s report.

A109. The retention and maintenance of engagement documentation includes managing the safe custody, integrity, accessibility or retrievability of the underlying data. The retention and maintenance of engagement documentation may involve the use of IT applications. The integrity of engagement documentation

\textsuperscript{13} Proposed ISA 220 (Revised), paragraphs A27–A29
\textsuperscript{14} Proposed ISA 220 (Revised), paragraph 32
documentation may be compromised if it is altered, supplemented or deleted without the appropriate authorization to do so, or if it is permanently lost or damaged.

A111. Law, regulation, relevant ethical requirements or other professional standards may prescribe the retention period for engagement documentation. If the retention periods are not prescribed, the firm may, in determining an appropriate retention period, consider the nature of the engagements performed by the firm and the firm’s circumstances, for example, whether the engagement documentation is needed to provide a record of matters of continuing significance to future engagements. In the case of audits of financial statements, the retention period would ordinarily be no shorter than five years from the date of the auditor’s report, or, if later, the date of the auditor’s report on the group financial statements, when applicable.

Quality Risk Considerations

A112A. Examples of how the quality risk considerations may give rise to quality risks related to the engagement performance quality objectives:

<table>
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<tr>
<th>The firm has a service delivery center located in another jurisdiction that performs certain aspects of the firm’s audit engagements (operating characteristics of the firm). This gives rise to a quality risk that the personnel are not appropriately directed and supervised and that their work is not appropriately reviewed.</th>
<th>The responses may include:</th>
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<td>• Establishing policies or procedures that address:</td>
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<td>  o What aspects of the engagement may be assigned to personnel in the service delivery center; and</td>
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<td></td>
<td>  o How the engagement partner, or their designee, is expected to direct, supervise and review the work undertaken by personnel in the service delivery center.</td>
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<td></td>
<td>• Assigning an individual with appropriate knowledge and experience to oversee personnel in the service delivery center.</td>
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<td>• Implementing IT applications that facilitate seamless face-to-face communication with personnel in the service delivery center.</td>
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<th>The firm operates in an environment where there is high competition for appropriately qualified personnel (the environment in which the firm operates). As a result, the firm tends to employ personnel who are still in the process of completing their tertiary education (the operating characteristics of the firm). This gives rise to a quality risk that the personnel are not sufficiently directed and supervised and their work reviewed.</th>
<th>The responses designed and implemented by the firm may include:</th>
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<td>• Allocating more time for engagement partners, or their designees, to spend on the engagement directing and supervising the engagement team and reviewing the work performed; and</td>
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<tr>
<td>and that the engagement team does not have the appropriate competence and capabilities to perform the engagement.</td>
<td>• Developing training programs that are designed to develop personnel, taking into consideration their general level of knowledge and experience.</td>
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| There is a small firm (operating characteristics of the firm) and the leadership of the firm is strongly dominated by one individual (characteristics of management). This gives rise to a quality risk that personnel do not bring differences of opinion that involve leadership to the attention of the firm. | The firm’s responses may include establishing policies or procedures that:  
• Specify how differences of opinion with the firm’s leadership should be raised; and  
• Require the difference of opinion to be resolved through consultation with a service provider, or a professional or regulatory body. |
| The firm’s engagement documentation is mostly in electronic format and there are increasing occurrences globally of security breaches to access confidential information (the environment in which the firm operates). This gives rise to a quality risk that the integrity of engagement documentation may be compromised. | The firm’s responses may include:  
• Employing specialized IT resources to focus on the firm’s IT security; and  
• Rigorous and ongoing reviews of the firm’s IT processes to determine that they are up-to-date in preventing unauthorized access. |
| The firm performs audits of financial statements for entities that operate in an industry where there are highly complex accounting estimates (the types of entities for whom the firm performs engagements). This gives rise to a quality risk that engagement teams exercise inappropriate professional judgment or professional skepticism and that the engagement team does not have the appropriate competence and capabilities to perform the engagement. | The firm’s responses may include establishing policies or procedures that require:  
• The assignment of individuals to the engagement that have appropriate experience in performing audits of financial statements of entities in the industry;  
• Consultation on the highly complex accounting estimates with certain individuals in the firm; and  
• An engagement quality review to be performed. |
| The firm performs compilation engagements for entities that operate in an industry where there are complex financial statement disclosures (the types of entities for whom the firm performs engagements). This gives rise to a quality risk that engagement teams exercise inappropriate professional judgment in compiling the disclosures. | The firm’s responses may include:  
• Assigning individuals to the engagement that have appropriate experience in compiling financial statements of entities in the industry;  
• Developing disclosure checklists to be completed by the engagement team; and |
Proposed ISQM 1: Draft Extracts to Reflect Proposals in Agenda Item 7 (Clean)

IAASB Main Agenda (December 2019)

Agenda Item 7-A

Page 41 of 65

• Requiring an internal preissuance review of the financial statements before they are submitted to the entity.

Resources (Ref: Para. 38–39)

A113. Resources for the purposes of the resources component include:

- Human resources.
- Technological resources, for example, IT applications.
- Intellectual resources, for example, written policies or procedures, a methodology or guides.

Financial resources are also relevant to the system of quality management because they are necessary for obtaining, developing and maintaining the firm’s human resources, technological resources and intellectual resources. The governance and leadership component addresses appropriate resource planning for all resources. Given the nature of financial resources, the quality objectives and responses in governance and leadership, such as those that address financial and operational priorities, address financial resources. This component addresses specific aspects of human resources, technological resources and intellectual resources.

A114. Resources are pervasive to all components of the system of quality management and therefore the firm’s responses for resources will address assessed quality risks specific to resources, as well as assessed quality risks for other components. Such responses may be designed and implemented individually for each component, or they may be designed and implemented for all components holistically.

A115. Resources may be internal to the firm, or may be obtained externally from a network, network firm or service provider. In such circumstances, in addition to complying with the requirements for resources set out in this component, the firm is also required to comply with paragraphs 58–63 addressing network requirements or network services or paragraphs 64–65 addressing the use of resources from a service provider.

A116. Other components include responses that may affect or relate to the resources component. For example, the information necessary to facilitate the appropriate assignment of personnel or the evaluation of personnel is identified, captured, processed and maintained through the information and communication component.

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

A117. Competence is the ability of the individual to perform a role to a defined standard and goes beyond knowledge of principles, standards, concepts, facts, and procedures; it is the integration and application of technical competence, professional skills, and professional ethics, values and attitudes. Competence can be developed through a variety of methods, including professional education, continuing professional development, training, work experience or coaching of less experienced engagement team members by more experienced engagement team members.

A118. Professional standards, law or regulation may establish requirements addressing competence and capabilities. For example, law or regulation of a jurisdiction may establish requirements for the professional licensing of engagement partners, including requirements regarding their professional education and continuing professional development.
A119. The firm’s responses that relate to the hiring, development and retention of personnel may include:

- Recruitment strategies that focus on selecting individuals who have the ability to develop the competence necessary to consistently perform quality engagements or activities in relation to the operation of the system of quality management.

- Training programs, which may form part of the firm’s intellectual resources, to develop personnel’s competence to enable them to perform their roles and responsibilities.

- Policies addressing the continuing professional development of personnel, including personnel’s responsibility to maintain an appropriate level of continuing professional development, and training resources and other assistance provided by the firm.

- Evaluation mechanisms that establish competency areas and other performance measures, and facilitate the evaluation of personnel at appropriate intervals.

- Compensation, promotion and other incentives, appropriate to the nature and circumstances of the firm, for all personnel, including engagement partners, the individuals assigned ultimate responsibility and accountability for the firm’s system of quality management, and the individual(s) assigned operational responsibility for the firm’s system of quality management or other aspects of the system of quality management.

A120. Human resources assigned to engagements or other roles may include personnel in a service delivery center, human resources engaged by the firm (i.e., a service provider) or human resources from a network or network firm.

A121. Timely evaluations and feedback help support and promote the continual development of the competence of personnel. Less formal methods of evaluation and feedback may be used, for example, in the case of smaller firms with fewer personnel.

A122. Evaluations of personnel may be used by the firm in determining the compensation, promotion, or other incentives. In some circumstances, simple or informal incentives that are not based on monetary rewards may be appropriate.

A123. The firm may take action for personnel who demonstrate actions or behaviors that negatively affect quality, including failing to demonstrate a commitment to quality, develop and maintain the competence to perform their role or implement the firm’s responses as designed (e.g., an individual breaches the firm’s policies or procedures related to independence). The consequences or actions taken by the firm may depend on the severity of the failure and the frequency of occurrence and may include, for example:

- Training or other professional development;

- Considering the effect of the matter on the evaluation, compensation, promotion or other incentives of the individual(s); or

- Taking disciplinary action against the individual(s), if appropriate, depending on the severity of the failure and the frequency of occurrence.

**Technological Resources (Ref: Para. 38(e))**

A124. Technological resources, which are typically IT applications, form part of the firm’s IT environment. The firm’s IT environment also includes the supporting IT infrastructure and the IT processes and
human resources involved in those processes that the firm uses in the operation of its system of quality management:

- An IT application is a program or a set of programs that is designed to perform a specific function directly for the user or, in some cases, for another application program.
- The IT infrastructure is comprised of the network, operating systems, and databases and their related hardware and software.
- The IT processes are the firm’s processes to manage access to the IT environment, manage program changes or changes to the IT environment and manage IT operations, which includes monitoring the IT environment.

A125. An IT application, IT infrastructure or IT process may serve multiple purposes within the firm and some of the purposes may be unrelated to the system of quality management. Only IT applications, IT infrastructure or IT processes that support the firm’s system of quality management are relevant for the purposes of this ISQM.

A126. In some cases, the network may require the firm to use an IT application, the firm may choose to use an IT application provided by the network, or the firm may purchase an IT application from a service provider. The firm may also use the network or a service provider to manage certain aspects of the IT processes.

A127. Paragraph 40(a) addresses the firm’s responsibility to establish an information system that supports the system of quality management, which may include the use of IT elements and records in the form of digital information. The firm may also use certain IT applications to enable the operation of various aspects of its system of quality management, for example, IT applications used to monitor compliance with relevant ethical requirements and record and maintain information about independence. Other IT applications may be implemented by the firm for use by engagement teams in performing engagements, for example, the firm may mandate the use of an IT application that facilitates the documentation of work performed or the firm may offer an IT application to perform analyses of the client’s information that engagement teams may choose to use.

A128. The IT environment for a larger firm may be comprised of customized or integrated IT applications, with dedicated human resources to manage the IT infrastructure and IT processes. The IT environment for smaller firms may comprise IT applications that are commercial software, and the IT processes may involve authorizing access to the IT applications and processing updates to the IT applications.

A129. The use of IT applications or other aspects in the IT environment may give rise to quality risks, for example:

- Inappropriate reliance on IT applications that are inaccurately processing data, processing inaccurate data, or both.
- Unauthorized access to data that may result in breaches in confidentiality of information contained in the data, destruction of data or improper changes to data.
- Potential loss of data or inability to access data or IT applications as required.
- Unauthorized changes to IT applications or other aspects of the IT environment.
- Failure to make necessary changes to IT applications or other aspects of the IT environment.
The nature and significance of these quality risks may vary based on whether, and the extent to which, the firm relies on IT, including automated controls, to enable the design, implementation and operation of the system of quality management. General IT controls may be part of the responses designed and implemented by the firm to address quality risks identified and assessed by the firm.

A130. When implementing an IT application, particularly a customized IT application that has been developed specifically for the firm, it is necessary for the firm to determine that the IT application operates appropriately. This determination may involve consideration of whether:

- The data inputs are appropriate and confidentiality of the data is preserved.
- The IT application operates as designed and achieves the purpose for which it is intended.
- The outputs of the IT application achieve the purpose for which they will be used.
- It is clear how users are required to interact with and use the IT application and users have appropriate support.
- The general IT controls necessary to support the IT application’s continued operation as designed are appropriate.

The firm may specifically prohibit the use of IT applications or features of IT applications, until such time that it has been determined that they operate appropriately and have been approved for use by the firm.

A131. Engagement teams may need training on how to use the IT applications appropriately. Furthermore, for certain IT applications, specialized skills may be needed to utilize the IT application effectively and the firm may need to specify procedures that set out how the engagement team operates the IT application. For example, in some instances the firm’s IT application for the performance of engagements may require that the engagement team complete certain information about the client and the circumstances of the engagement in order to generate an appropriate engagement file template for the circumstances of the engagement.

Intellectual Resources (Ref: Para. 38(f))

A132. Intellectual resources include the information the firm uses to promote consistency in the performance of engagements, for example, written policies or procedures, a methodology, industry or subject matter-specific guides, accounting guides, standardized documentation or access to information sources (e.g., subscriptions to websites that provide in-depth information about entities or other information that is typically used in the performance of engagements).

A133. The intellectual resources may be made available to personnel through technological resources, for example, the firm’s audit methodology may be embedded in the audit IT application that facilitates the planning and performance of the engagement. The firm may also need human resources to develop, implement and maintain its intellectual resources. Intellectual resources may also be dependent on relevant and reliable information that is identified, captured, processed and maintained through the firm’s information and communication component.

Personnel’s Use of Technological and Intellectual Resources (Ref: Para. 38(g))

A134. The firm may establish policies or procedures regarding the use of the firm’s technological and intellectual resources. Such policies or procedures may:
Proposed ISQM 1: Draft Extracts to Reflect Proposals in Agenda Item 7 (Clean)

IAASB Main Agenda (December 2019)

Agenda Item 7-A

Page 45 of 65

• Require the use of certain IT applications or intellectual resources in performing engagements, for example, engagement teams may be required to use the firm’s methodology when performing the engagement. They may also be required to use IT applications that facilitate the performance of the engagement and the archival of the engagement file.

• Specify the qualifications or experience of personnel that are needed to use the IT application, for example, the firm may specify the qualifications or expertise needed to use an IT application for the performance of automated techniques and to interpret the results.

• Set out how the technological or intellectual resources are to be used.

Information and Communication (Ref: Para. 40–41)

A135. Obtaining, generating or communicating information is generally an ongoing process that involves all personnel and encompasses the dissemination of information within the firm and externally. Information and communication is pervasive to all components of the system of quality management and therefore the firm’s responses for information and communication address assessed quality risks specific to information and communication, as well as assessed quality risks for the other components. Such responses may be designed and implemented individually for each component, or for all components holistically. Paragraphs A51, A69, A76 and A116 explain and provide examples of how the information and communication component supports the design, implementation and operation of the other components of the system of quality management.

The Firm’s Information System (Ref: Para. 40(a))

A136. Reliable information includes information that is accurate, complete, timely and valid to enable the proper functioning of the firm’s system of quality management and to support decisions regarding the system of quality management.

A137. The information system in smaller firms is likely to be less sophisticated than in larger firms and involve a less complex IT environment.

A138. The information system may include the use of manual or IT elements, which affect the manner in which information is identified, captured, processed, maintained and communicated. The procedures to identify, capture, process, maintain and communicate information may be enforced through IT applications, and in some cases may be embedded within the firm’s responses for other components. For example, the firm’s responses for monitoring and remediation may define how information from the results of the firm’s monitoring activities is captured, processed, maintained and communicated. In addition, digital records may replace or supplement physical records. For example, the firm may use an IT application to obtain a documented confirmation of compliance with independence requirements from personnel.

Communication Within the Firm (Ref: Para. 40(b)–(d), 41(a)–(b))

A139. The firm and its personnel share relevant information to enable the proper functioning of the firm’s system of quality management. For example:

• The firm communicates information to engagement teams, such as information that is obtained during the firm’s acceptance and continuance process that is relevant to engagement teams in planning and performing engagements.

• Engagement teams communicate information to the firm, for example, information about:
The client obtained during the performance of an engagement that may have caused the firm to decline the client relationship or specific engagement had that information been known prior to accepting or continuing the client relationship or specific engagement.

The operation of the firm’s responses to assessed quality risks (e.g., concerns about the firm’s processes for assigning personnel to engagements).

In some cases, the information communicated by the engagement team may indicate a deficiency in the firm’s system of quality management.

- Personnel performing activities within the firm’s system of quality management share information. For example, the individual(s) assigned operational responsibility for compliance with independence requirements may communicate to the person with ultimate responsibility for the system of quality management changes in the independence requirements and how the firm’s policies or procedures have been updated in response to such changes.

Two-way communication may also be among the various parties, for example, engagement teams may communicate information directly to the personnel performing activities within the firm’s system of quality management.

A140. Matters communicated by the firm to engagement teams or other personnel performing activities within the firm’s system of quality management may include changes to the system of quality management, to the extent that the changes are relevant to their responsibilities and enables the personnel to take prompt and appropriate action in accordance with their responsibilities.

A141. Responsibility for operating the responses designed and implemented by the firm may be assigned to:

- The engagement team, as described in paragraph A62;

- Personnel performing activities within the firm’s system of quality management (e.g., assigning responsibility for the performance of an engagement quality review to an engagement quality reviewer); or

- A combination of the engagement team and personnel performing activities within the firm’s system of quality management.

The firm may also use human resources external to the firm to assist in operating the responses.

Communication with External Parties (Ref: Para. 40(e), 41(c))

Communication Required by Law or Regulation (Ref: Para. 41(c)(i))

A142. Law, regulation or professional standards may require the firm to communicate information to external parties. For example:

- In circumstances when the firm becomes aware of non-compliance with laws and regulations by a client, relevant ethical requirements may require the firm to report the non-compliance with laws and regulations to an appropriate authority outside the client entity, or to consider whether such reporting is an appropriate action in the circumstances.

- Law, regulation or professional standards may require the firm to publish a transparency report and may specify the nature of the information that is required to be included in the transparency report.
Communication with the Network (Ref: Para. 41(c)(ii))

A143. When the firm belongs to a network, frequent communication with the network supports the network in establishing network requirements and providing network services that promote the consistent performance of quality engagements. Furthermore, the network’s communication of relevant information supports the firm in the design, implementation and operation of its system of quality management. Such communication may include matters related to independence, for example, in circumstances when relevant ethical requirements include requirements for independence that apply to network firms or employees of network firms.

Communication with Service Providers (Ref: Para. 41(c)(iii))

A144. When the firm uses a service provider, the service provider’s communication of relevant information to the firm that affects the firm’s system of quality management supports the firm in the design, implementation and operation of its system of quality management.

Communication to External Parties About the Firm’s System of Quality Management (Ref: Para. 41(c)(iv))

A145. The firm’s ability to maintain stakeholder confidence in the quality of its engagements may be enhanced through effective two-way communication between the firm and its stakeholders. For example, stakeholders’ perception of the quality of engagements performed by the firm may be improved when the firm is transparent about the activities that it has undertaken to address quality, and the effectiveness of those activities.

External parties who may use information about the firm’s system of quality management (Ref: Para. 41(c)(iv)(a))

A146. External parties may include management or those charged with governance of the firm’s clients, the firm’s network or network firms, external oversight authorities, other firms who use the work of the firm in the performance of engagements (e.g., in relation to a group audit) or service providers. External parties may also include users of the firm’s engagement reports, for example, current shareholders and credit providers of the entities for whom the firm performs engagements.

A147. The firm exercises professional judgment when taking into account whether there are external parties who may use information about the firm’s system of quality management. Whether there are such external parties may depend on the nature of the engagements the firm performs and the types of entities for which such engagements are performed. For example, for a firm that performs audits of financial statements of listed entities or entities that may be of significant public interest described in paragraph A23, external parties such as shareholders of such entities may use a transparency report or similar publication to inform their understanding of the quality of engagements performed by the firm. On the other hand, for a firm that only performs compilation engagements, external parties who may use information about the firm’s system of quality management may be limited, and they may obtain such information through discussions and direct interaction with the firm.

Nature and circumstances of the firm (Ref: Para. 41(c)(iv)(b))

A148. Factors that may affect the firm’s operating environment include the nature and circumstances of the financial markets in which the firm operates and the understanding and interest that external parties have expressed about the engagements undertaken by the firm, and the firm’s processes in performing the engagements.
Proposed ISQM 1: Draft Extracts to Reflect Proposals in Agenda Item 7 (Clean)
IAASB Main Agenda (December 2019)

Agenda Item 7-A
Page 48 of 65

Nature, timing, extent and content of communications to external parties about the system of quality management (Ref: Para. 41(c)(iv))

A149. The form of communication to external parties may include a publication such as a transparency report or audit quality report, webpage, targeted communication to specific stakeholders (e.g., information about the results of the firm’s monitoring and remediation process), or direct conversations with the external party.

A150. The information that is communicated to external parties about the firm’s system of quality management may depend on a variety of factors, including the form of the communication, the nature and circumstances of the firm and the external parties with whom the communication is being undertaken. For example, the communication may contain information about:

- The nature and circumstances of the firm, such as the organizational structure and operating environment and whether it is part of a network.
- The firm’s governance and leadership, such as its culture and commitment to quality and information about the individuals responsible for the leadership of the firm.
- Factors that contribute to quality engagements, for example, such information may be presented in the form of engagement quality indicators with appropriate narrative to explain the indicators.
- The results of the firm’s monitoring activities and external inspections, and how the firm has remediated identified deficiencies or is otherwise responding to them.
- The evaluation undertaken in accordance with paragraph 55 of whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved, including the basis for the judgments made in undertaking the evaluation.
- How the firm has responded to emerging developments and changes in the circumstances of the firm or its engagements, including how the system of quality management has been adapted to respond to such changes.

A151. Information that is communicated to external parties about the firm’s system of quality management that has the following attributes contributes to an enhanced understanding of the quality of the engagements performed by the firm:

- The information is specific to the circumstances of the firm and is prepared and presented in a timely manner. Relating the matters in the firm’s communication directly to the specific circumstances of the firm may help to minimize the potential that such information becomes overly standardized and less useful over time.
- The information is presented in a clear and understandable manner that is neither misleading nor would inappropriately influence the users of the communication (e.g. the information is appropriately balanced towards positive and negative aspects of the matter being communicated).
- The information is accurate and complete in all material respects and does not contain information that is misleading.
- The information takes into consideration the information needs of the users for whom it is intended. In considering the information needs of the users, the firm may consider matters such...
as the level of detail that users would find meaningful and whether users have access to relevant information through other sources, for example, information located on the firm’s website.

A152. In circumstances when the firm is part of a network, it may be useful to provide information about the relationship between the firm and the network in certain external communications, such as a transparency report. Such information helps facilitate an understanding of the responsibilities of the firm and the network, and clarifies how the network requirements or network services promote the consistent performance of quality engagements across the network firms. Such information may include:

- The nature of the relationship between the firm and the network and the overall structure of the network.
- Requirements established by the network for the firm or network services that are used by the firm in its system of quality management.
- Information about the overall scope and results of network monitoring activities across the network firms that the network has provided to the firm in accordance with paragraph 61, if applicable.

In some circumstances, the network may provide external communication about the above matters, for example, in the form of a network transparency report, which may support the firm in communicating the information.

A153. In some cases, law or regulation may preclude the firm from communicating information related to its system of quality management externally. For example, certain information may be subject to privacy or secrecy laws or regulations or the firm may be precluded from communicating certain information because of the duty of confidentiality under law, regulation or relevant ethical requirements.

Specified Responses (Ref: Para. 41A)

A153A. The responses specified in this ISQM may address quality risks that are relevant to multiple components.

Responsibility for Compliance with Independence Requirements (Ref: Para. 41A(a))

A153B. Compliance with independence requirements is essential to the performance of audits, or reviews of financial statements, or other assurance engagements, and is an expectation of stakeholders relying on the firm’s reports. Assigning operational responsibility for compliance with independence requirements to an individual(s) may be particularly important in circumstances when the firm is large or has multiple locations, so that a robust and consistent approach is designed and implemented by the firm to deal with independence requirements.

Complaints and Allegations (Ref: Para. 41A(b))

A153C. Establishing policies or procedures for dealing with complaints and allegations about a failure to perform work in accordance with professional standards and applicable legal and regulatory requirements, or non-compliance with the firm’s policies or procedures, may assist the firm in preventing engagement reports from being issued that are inappropriate. It also may assist the firm in:
Proposed ISQM 1: Draft Extracts to Reflect Proposals in Agenda Item 7 (Clean)
IAASB Main Agenda (December 2019)

• Identifying and dealing with individual(s), including leadership, who do not act or behave in a manner that supports the firm’s commitment to quality; or
• Identifying findings that may be deficiencies in the system of quality management, and remediating such deficiencies.

A153D. Complaints and allegations may originate from within or outside the firm and they may be made by personnel or external parties, such as clients or others within the firm’s network.

Engagements Subject to an Engagement Quality Review (Ref: Para. 41A(c))

[Placeholder for application material (ISQM 2 TF)]

Monitoring and Remediation Process (Ref: Para. 42–54)

Designing and Performing Monitoring Activities (Ref: Para. 44–46)

A155. The monitoring activities undertaken by the firm may detect a deficiency, or may prevent a deficiency from arising through detecting a finding and responding to the finding before it rises to a level of severity or pervasiveness that results in a deficiency.

A156. The firm’s monitoring activities may comprise ongoing monitoring activities, periodic monitoring activities or a combination of both. In most cases, ongoing monitoring activities identify findings in the system of quality management in a timelier manner.

A157. Monitoring activities may include the inspection of in-process engagements. Inspections of engagements are designed to monitor that an aspect of the system of quality management is designed, implemented and operating in the manner intended. In some circumstances, the system of quality management may include responses that are designed to review engagements while in process which appear similar in nature to an inspection of in-process engagements (e.g., reviews that are designed to detect failures or shortcomings in the system of quality management so that they can prevent an assessed quality risk from occurring). Determining the purpose of an action is necessary in determining its design and implementation, and where it fits within the system of quality management (i.e., whether it is a monitoring activity (inspection of in-process engagement) or a response to address an assessed quality risk (an engagement review)).

A158. The nature, timing and extent of the monitoring activities may also be affected by other factors, including:

• The involvement of the network in monitoring activities.
• The resources that the firm intends to use to enable monitoring activities, for example, the use of IT applications in addition to human resources.

A159. When performing monitoring activities, the firm may determine that changes to the nature, timing and extent of the monitoring activities are needed. For example, the firm may identify findings that indicate the need for more extensive monitoring activities.

The Reasons for the Assessments Given to the Quality Risks (Ref: Para. 44(a)(ii))

A159A. Example of how the quality risk considerations may affect the nature, timing and extent of the monitoring activities:
The firm performs audits of financial statements for entities that operate in an industry where there are highly complex accounting estimates (the types of entities for whom the firm performs engagements). This gives rise to a quality risk that engagement teams exercise inappropriate professional judgment or professional skepticism.

The firm’s responses may include establishing policies or procedures that require:

- The assignment of individuals to the engagement that have appropriate experience in performing audits of financial statements of entities in the industry;
- Consultation on the highly complex accounting estimates with certain individuals in the firm; and
- An engagement quality review to be performed.

In designing the monitoring activities, the firm may determine that for each audit of financial statements of an entity operating in that industry, an in-process engagement inspection will be performed to determine that:

- The individuals assigned to the engagement have appropriate experience in performing audits of financial statements of entities in the industry;
- The engagement team has initiated consultation on the highly complex accounting estimates, where appropriate; and
- An engagement quality reviewer has been appointed to perform the review and has been appropriately involved in the engagement as it has progressed.

The Design of the Response or the Design of the Firm’s Risk Assessment Process (Ref: Para. 44(b))

A160. How a response is designed may affect the nature, timing and extent of the monitoring activities. For example, the frequency of a monitoring activity for a response that occurs annually will differ from the frequency of a monitoring activity for a response that occurs multiple times on a daily basis. Furthermore, the extent to which the response utilizes technological resources may affect how a monitoring activity is designed.

A161. The monitoring activities may also include monitoring of the firm’s risk assessment process, to determine that it is designed and implemented in a manner that enables the firm to establish quality objectives, identify and assess quality risks and design and implement responses. How the firm’s risk assessment process is designed (e.g., a centralized or decentralized process, or the frequency of review) may affect the nature, timing and extent of the monitoring activities.

Changes in the System of Quality Management (Ref: Para. 44(c))

A162. Changes in the system of quality management include:

- Changes to address an identified deficiency in the system of quality management.
- Changes to the responses, for example, because they have become obsolete over time or more effective responses are designed and implemented, such as the use of IT applications to replace manual processes.

When changes occur, previous monitoring activities undertaken by the firm may no longer provide the firm with information to support the evaluation of the system of quality management and, therefore, the firm’s monitoring activities may include monitoring of those areas of change.
Previous Monitoring Activities (Ref: Para. 44(d), 50)

A163. The results of the firm's previous monitoring activities may indicate areas of the system where a deficiency could arise, particularly areas where there is a history of deficiencies. Furthermore, the monitoring activities may need to evaluate the effectiveness of the remedial actions that have been implemented to address deficiencies previously identified.

A164. Previous monitoring activities undertaken by the firm on areas of the system of quality management that have not changed may no longer provide the firm with information to support the evaluation of the system, for example, because of the time that has elapsed since the monitoring activities were undertaken.

Other Relevant Information (Ref: Para. 44(e))

A165. In addition to the sources of information indicated in paragraph 44(e), other relevant information may include:

- Information communicated by the network in accordance with paragraphs 60(c) and 61 about the firm's system of quality management, including the network requirements or network services that the firm has included in its system of quality management.
- Information communicated by a service provider about the resources the firm uses in its system of quality management.

A166. The results of external inspections or other relevant information, both internal and external, may indicate that previous monitoring activities undertaken by the firm failed to identify a deficiency in the system of quality management. This information may affect the firm's consideration of the appropriate nature, timing and extent of the monitoring activities.

A167. External inspections are not a substitute for the firm's internal monitoring activities. Nevertheless, the results of external inspections may inform the nature, timing and extent of the monitoring activities.

Engagement Inspections (Ref: Para. 45)

A168. The identified quality risks that may arise as a result of the nature and circumstances of the engagements performed by the firm that may affect the firm's selection of completed engagements for inspection may relate to:

- The types of engagements performed by the firm, and the extent of the firm's experience in performing the type of engagement.
- The types of entities for which engagements are undertaken, for example, entities that are listed, have a large number and wide range of stakeholders, or circumstances when the firm has performed an engagement for an entity that operates in an industry that is new to the firm.

A168A. Other quality risk considerations may also affect the selection of completed engagements for inspection, such as the complexity and operating characteristics of the firm, including the size of the firm and number of geographical locations.

A169. Selecting a completed engagement for inspection for each engagement partner may assist the firm in monitoring whether each engagement partner has fulfilled their overall responsibility for managing and achieving quality on the engagements they are assigned to. The following factors may affect the
firm’s determination of the appropriate cyclical basis for selecting engagement partners for inspection of completed engagements:

- The tenure and experience of the engagement partner, including experience in performing engagements for entities operating in the industries assigned to the engagement partner.
- The results of previous internal inspections, or results of external inspections related to the engagement partner.
- The nature of engagements performed by the engagement partner.

A170. The matters considered in an inspection of an engagement depends on how the inspection will be used to monitor the system of quality management. Ordinarily, the inspection of an engagement includes determining that responses designed to be implemented at the engagement level have been implemented, for example, the firm may determine whether engagement teams have applied the firm’s methodology appropriately.

Example of how the matters considered in an inspection are affected by how the inspection will be used to monitor the system of quality management:

The example in paragraph A159A demonstrates a circumstance when an in-process engagement inspection is designed to inspect only specific aspects of the engagement.

Individuals Performing the Monitoring Activities (Ref: Para. 46)

A171. The provisions of relevant ethical requirements are relevant in designing the policies or procedures addressing the objectivity of the individuals performing the monitoring activities.

Examples of a self-review threat regarding individuals performing the monitoring activities:

A self-review threat may arise when an individual who performs:

- An inspection of an engagement was:
  - In the case of an audit of financial statements, an engagement team member or the engagement quality reviewer of that engagement or an engagement for a subsequent financial period; or
  - For all other engagements, an engagement team member or the engagement quality reviewer of that engagement.
- Another type of monitoring activity had participated in designing, executing or operating the response being monitored.

Evaluating Findings and Identifying Deficiencies (Ref: Para. 47)

A172. Findings about the firm’s system of quality management may include matters related to individual engagements, including those identified from inspection of engagements.

A173. The results of monitoring activities, results of external inspections and other relevant information may reveal other observations about the firm’s system of quality management, such as:

- Actions, behaviors or conditions that have given rise to positive outcomes in the context of quality or the effectiveness of the system of quality management; or
• When findings are identified, observations that similar findings did not arise in other circumstances that are of a similar nature to the matter to which the finding relates (e.g., in relation to engagements, observations that findings were not observed on other engagements of a similar nature).

Other observations may be useful to the firm as they may assist the firm in investigating the root cause(s) of identified deficiencies, indicate practices that the firm can support or apply more extensively (e.g., across all engagements) or highlight opportunities for the firm to enhance the system of quality management.

A172A. The firm may exercise professional judgment in determining whether a finding, individually or in combination with other findings, is of such significance that it results in a deficiency in the system of quality management. Significance is judged by the firm, taking into consideration the relative importance of the finding in the context of the system of quality management providing reasonable assurance that the objectives of the system are achieved. The firm’s judgments may be affected by quantitative and qualitative factors relevant to the finding. In some circumstances, the firm may determine it appropriate to investigate the root cause(s) of a finding in order to determine whether a finding is a deficiency.

A172B. Not all findings, including engagement findings, will be a deficiency in the system of quality management. Therefore, not all findings are subject to further actions, such as investigating the root cause(s) of a deficiency and remediating a deficiency.

A175. Examples of quantitative and qualitative factors that a firm may consider in determining whether a finding(s) is of such significance that it results in a deficiency

Quality risks and responses
• If the finding relates to a response:
  o The design of the response.
  o The nature of the assessed quality risk to which the response relates, and the extent to which the finding indicates that the assessed quality risk has not been addressed.
  o Whether there are other responses that address the same assessed quality risk and whether there are findings for those responses.

Nature of the finding and its pervasiveness
• The nature of the finding. For example, a finding related to leadership’s actions and behaviors may be qualitatively significant, given the pervasive effect this could have on the system of quality management as a whole.

• Whether the finding, in combination with other findings, indicates a trend or systemic issue. For example, similar engagement findings that appear on multiple engagements may indicate a systemic issue.
Error rates and population size

- The design of the monitoring activity from which the finding arose. For example, the firm may consider the tolerable error rate of the activity and whether it was designed to focus on specific areas of risk or the whole population.

- The extent of the monitoring activity from which the finding arose, including the size of sample selected relative to the size of the entire population.

- The extent of the findings in relation to the sample of the population covered by the monitoring activity. For example, in the case of inspection of engagements, the number of engagements selected where the finding was identified, relative to the total number of engagements selected.

A175A. Evaluating findings and identifying deficiencies, evaluating the severity and pervasiveness of a deficiency and investigating the root cause(s) of a deficiency are iterative.

Examples of the iterative nature of evaluating findings and identifying deficiencies, evaluating identified deficiencies, and investigating the root cause(s) of deficiencies:

- In investigating the root cause(s) of a deficiency, the firm identifies a circumstance that also existed in relation to another finding that is not considered a deficiency. As a result, the firm adjusts its evaluation of the other finding and classifies it as a deficiency.

- In evaluating the severity and pervasiveness of a deficiency, the firm identifies a trend or systemic issue that correlates with other findings that are not considered deficiencies. As a result, the firm adjusts its evaluation of the other findings and also classifies them as deficiencies.

A177. The results of monitoring activities, results of external inspections and other relevant information (e.g., network monitoring activities or complaints and allegations) may reveal information about the effectiveness of the monitoring and remediation process. For example, external inspection findings may indicate findings in the system of quality management that have not been identified by the firm’s monitoring and remediation process, which may highlight a deficiency in that process.

Root Cause of the Identified Deficiencies (Ref: Para. 48(a))

A179. The objective of investigating the root cause(s) of identified deficiencies is to understand the underlying circumstances that caused the deficiencies. Performing a root cause analysis involves those performing the assessment exercising professional judgment based on the evidence available.

A180. The nature, timing and extent of the procedures undertaken to understand the root cause(s) of an identified deficiency may vary based on the nature of the identified deficiencies and their possible severity and the quality risk considerations.
Examples of the nature of identified deficiencies, their possible severity and quality risk considerations:

- **The nature of the deficiency:** A deficiency identified with respect to an engagement report being issued that was inappropriate and related to an audit of financial statements of a listed entity or a deficiency with respect to leadership’s actions and behaviors regarding quality.

- **The possible severity of the deficiency:** A deficiency identified across multiple engagements or policies or procedures that appear to have high rates of non-compliance.

- **Quality risk considerations:** The complexity and operating characteristics of the firm, including the size of the firm, the geographical dispersion of the firm, how the firm is structured or the extent to which the firm concentrates or centralizes its processes or activities. For example:
  - The procedures to understand the root cause(s) of a deficiency in a small firm with a single location may be simple as the information to inform the understanding may be readily available and concentrated, and the root cause(s) may be more apparent.
  - The procedures to understand the root cause(s) of a deficiency in a large firm with multiple locations, may include using personnel specifically trained on investigating the root cause(s) of identified deficiencies, and developing a methodology with more formalized procedures for identifying root cause(s).

A181. In investigating the root cause(s) of identified deficiencies, the firm may consider why deficiencies did not arise in other circumstances that are of a similar nature to the matter to which the deficiency relates. For example, in relation to engagements, the firm may consider why the deficiencies did not arise on engagements of a similar nature. Such information may also be useful in determining how to remediate an identified deficiency.

A182. Identifying a root cause(s) that is appropriately specific may support the firm’s process for remediating identified deficiencies.

**Example of identifying a root cause(s) that is appropriately specific:**

- The firm identifies that engagement teams performing audits of financial statements are failing to obtain sufficient appropriate audit evidence on accounting estimates where management’s assumptions have a high degree of subjectivity. While the firm notes that engagement teams are not exercising appropriate professional skepticism, the underlying root cause of this issue may relate to another matter, such as a cultural environment that does not encourage engagement team members to challenge individuals with greater authority or insufficient direction, supervision and review on engagements.

A182A. Although not required by this ISQM, investigating the root cause of positive outcomes may reveal opportunities for the firm to improve, or further enhance, the system of quality management. Identifying the root cause of positive outcomes and understanding the underlying circumstances that led to the positive outcomes may also help the firm to identify the root causes of identified deficiencies and in determining how to remediate identified deficiencies.
Evaluating the Severity and Pervasiveness of Identified Deficiencies (Ref: Para. 48(b))

A183. Factors the firm may consider in evaluating the severity and pervasiveness of an identified deficiency include:

- The nature of the identified deficiency, including the aspect of the firm’s system of quality management to which the deficiency relates, and whether the deficiency is in the design, implementation or operation of the system of quality management;
- The root cause(s) of the identified deficiency;
- The frequency with which the underlying finding occurred; and
- The magnitude of the identified deficiency, the rate at which it occurred and the duration of time that it existed.

A183A. The severity and pervasiveness of deficiencies affects the evaluation of the system of quality management that is undertaken by the individual(s) assigned ultimate responsibility and accountability for the system of quality management.

Responding to Identified Deficiencies (Ref: Para. 49–50)

A184. The nature, timing and extent of remedial actions may depend on a variety of other factors, including:

- The root cause(s), for example, whether it relates to an individual engagement, a certain category of engagements, or is more pervasive throughout the firm.
- The severity and pervasiveness of the identified deficiency and therefore the urgency in which it needs to be addressed.
- The effectiveness of the remedial actions in addressing the root cause(s), for example, the firm may need to implement more than one remedial action in order to effectively address the root cause(s), or may need to implement remedial actions as interim measures until the firm is able to implement more effective remedial actions.

A184A. In some circumstances, the remedial action may include modifying the firm’s quality objectives, assessed quality risks or responses, because it is determined that they are not appropriate.

Findings About a Particular Engagement (Ref: Para. 51)

A185. In circumstances when procedures were omitted or the report issued is inappropriate, the action taken by the firm may include:

- Consulting with appropriate individuals within the firm regarding the appropriate action.
- Discussing the matter with management of the entity or those charged with governance.
- Performing the omitted procedures.

The actions taken by the firm do not relieve the firm of the responsibility to take further actions relating to the finding in the context of the system of quality management, including evaluating the findings, identifying deficiencies and if it is determined that a deficiency exists, investigating the root cause(s) of the identified deficiency.
Ongoing Communication Related to the Monitoring and Remediation (Ref: Para. 52–54)

A186. The information communicated about the monitoring and remediation to the individual(s) assigned ultimate responsibility and accountability for the system of quality management and the individual(s) assigned operational responsibility for the system of quality management provides the basis for the evaluation of the system of quality management, as required by paragraph 65A.

Network Requirements or Network Services (Ref: Para. 58–62)

A192. In some circumstances, the firm may belong to a network. Networks may establish requirements regarding the firm’s system of quality management or may make services or resources available that the firm may choose to implement or use in the design, implementation and operation of its system of quality management. Such requirements or services may be intended to promote the consistent performance of quality engagements across the firms that operate as part of the network. The extent to which a network will provide the firm with quality objectives, quality risks and responses that are common across the network will depend on the firm’s arrangements with the network.

Examples of network requirements:

- Requirements for the firm to include identified quality risks in the firm’s system of quality management that are common across the network firms.
- Requirements for the firm to include responses, including resources, in the firm’s system of quality management that are common across the network firms. Such responses designed by the network may include network policies or procedures that specify the leadership roles and responsibilities, including how the firm is expected to assign authority and responsibility within the firm, network developed methodologies for the performance of engagements or IT applications.
- Requirements that the firm be subject to the network’s monitoring activities. These monitoring activities may relate to network requirements (e.g., monitoring that the firm has implemented the network’s methodology appropriately), or to the firm’s system of quality management in general.

Examples of network services:

- Services or resources that are optional for the firm to use as a response in its system of quality management, such as voluntary training programs, or a service delivery center established at the network level, or by another firm or group of firms within the same network.

A194. The network may establish responsibilities for the firm in implementing the network requirements or network services. For example, in the case of implementing an IT application developed by the network, the firm may need to have the appropriate IT infrastructure and IT processes in place.

A195. The firm’s understanding of the network requirements or network services and the firm’s responsibilities relating to the implementation thereof may be obtained through inquiries of, or documentation provided by, the network about matters such as:

- The network’s governance and leadership.
- The procedures undertaken by the network in designing, implementing and, if applicable, operating, the network requirements or network services.
• How the network identifies and responds to changes that affect the network requirements or network services or other information, for example, changes in the professional standards or information that indicates a deficiency in the network requirements or network services.

• How the network monitors the appropriateness of the network requirements or network services, which may include through the network firms’ monitoring activities, and the network’s processes for remediating identified deficiencies.

Network Requirements or Network Services in the Firm’s System of Quality Management (Ref: Para. 59)

A196. The characteristics of the network requirements or network services are also a quality risk consideration in the firm’s risk assessment process.

Example of a network requirement or network service that gives rise to a quality risk:
A network requires the firm to use an IT application for the acceptance and continuance of client relationships and specific engagements that is standardized across the network. This gives rise to a quality risk that the IT application does not appropriately address matters in law or regulation that need to be considered by the firm in accepting and continuing client relationships and specific engagements.

A197. Network requirements may promote the consistent performance of quality engagements across the firms that operate as part of the network, and therefore the firm may be expected by the network to implement the network requirements. Nevertheless, the firm may need to adapt or supplement the network requirements such that they are appropriate for the nature and circumstances of the firm and the engagements it performs, taking into account the quality risk considerations.

A198. Examples of how the network requirements or networks services may need to be adapted or supplemented:

<table>
<thead>
<tr>
<th>The network requires the firm to include additional and more granular quality objectives in the system of quality management, in addition to the quality objectives required by this ISQM.</th>
<th>The firm:</th>
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<tr>
<td>The firm:</td>
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<tr>
<td>• Determines that quality objectives in addition to the network quality objectives are needed to address matters contained in jurisdictional law or regulation.</td>
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<tr>
<td>• Identifies and assesses quality risks related to all of the quality objectives, and designs and implements responses to address the quality risks.</td>
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</table>
The network requires the firm to include certain quality risks in the system of quality management, so that all firms in the network address the quality risks. The network does not provide an assessment of the quality risks.

As part of identifying and assessing quality risks, the firm assesses the quality risks that are required by the network. The firm also designs and implements responses to address the assessed quality risks.

The network requires that the firm design and implement certain responses.

As part of designing and implementing responses, the firm determines:

- How the responses required by the network will be incorporated into the firm’s system of quality management, given the nature and circumstances of the firm. This may include tailoring the response to reflect the nature and circumstances of the firm and the engagements performed by the firm (e.g., tailoring a methodology to include matters related to law or regulation).
- Which assessed quality risks the responses address.

Monitoring and Remediation Process (Ref: Para. 60–62)

A199. The monitoring activities undertaken by the network may affect the nature, timing and extent of the firm’s monitoring activities. For example, the network may undertake inspections of completed engagements of the firm, which may affect the extent of inspections of completed engagements undertaken by the firm.

A200. The results of the network’s monitoring activities of the firm’s system of quality management may include information such as:

- A description of the monitoring activities, including their nature, timing and extent;
- Findings from the monitoring activities and deficiencies identified; and
- The network’s evaluation of the root cause(s) of the identified deficiencies, the assessed effect of the deficiencies and recommended remedial actions.

A201. The information about the overall scope and results of the monitoring activities across the network firms’ systems of quality management may be an aggregation or summary of the information described in paragraph A200 for the network as a whole, including trends and common areas of identified deficiencies across the network, or positive outcomes that may be replicated across the network. Such information may be used by the firm in considering quality risk considerations or in determining the nature, timing and extent of the firm’s monitoring activities. The information may also
indicate deficiencies in network requirements or network services used by the firm in its system of quality management.

A202. In some circumstances, the firm may obtain information from the network about deficiencies identified in a network firm’s system of quality management that affects the firm, for example, when a network firm performs work for the firm’s engagements, such as in the capacity of a component auditor. The network may also gather information from the network firms regarding the results of external inspections over the network firms’ systems of quality management. In some instances, law or regulation in a particular jurisdiction may prevent the network from sharing information with other firms within the network or may restrict the specificity of such information.

A203. As network requirements or network services used by the firm form part of the firm’s system of quality management, they are also subject to the requirements of this ISQM regarding monitoring and remediation. The network requirements or network services may be monitored by the network, the firm, or a combination of both. For example, the network may undertake monitoring activities at a network level for a common methodology, however various monitoring activities at a firm level may support the evaluation of the methodology, including engagement inspections.

A204. In some cases the firm may need to implement its own remedial actions to address an identified deficiency, for example, in circumstances when the firm also needs to take remedial action to address the deficiency, the network has not taken appropriate remedial actions, or the network’s remedial actions will take time to effectively address the identified deficiency.

**Service Providers (Ref: Para. 64–65)**

A205. The firm may use human resources, technological resources or intellectual resources that are obtained from a service provider. The service providers used by the firm include individuals or organizations that are external to the firm, excluding networks, network firms or other structures or organizations in the network. Examples of resources from a service provider include:

- Human resources used to perform the firm’s monitoring activities or engagement quality reviews, or to provide consultation on technical matters.
- A commercial IT application used to perform audit engagements.
- Human resources used in the performance of engagements, for example, to attend a physical inventory count or inspect physical fixed assets at a remote location.
- External experts used in the performance of engagements. In such cases, there may be requirements in the other IAASB standards that address the competence, capabilities and objectivity of the external expert, understanding of the expert and agreement with the expert which apply in conjunction with the requirements of this ISQM.\(^{16}\)
- The use of resources from a service provider does not include using the work of an entity’s internal audit function in the performance of engagements, in accordance with ISA 610 (Revised 2013).\(^{16}\)

A206. The determination of whether the matters described in paragraph 64 are relevant for a service provider depends on a variety of factors including:

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\(^{15}\) See, for example, ISA 620, *Using the Work of an Auditor's Expert*.

\(^{16}\) ISA 610 (Revised 2013), *Using the Work of Internal Auditors*
- The nature of the resources provided by the service provider, including how and the extent to which it will be used within the firm.

- The reasons for the assessments given to the assessed quality risks to which the resource relates.

- Whether the resource itself gives rise to quality risks. For example, when the firm uses human resources from a service provider in the performance of engagements, there may be a quality risk that such resources do not have the competence and capabilities to perform the engagement, exercise inappropriate judgment when performing the engagement, do not implement the firm’s responses at the engagement level or do not fulfill their responsibilities in accordance with relevant ethical requirements. Such quality risks may also affect the management of quality at the engagement level. For example, in circumstances when the firm uses human resources from a service provider to assist in the performance of engagement procedures, there may be a need for the engagement partner to have greater oversight on a more frequent basis and perform more in-depth reviews of work performed by the individual.

A207. The firm may establish policies or procedures that address circumstances when a service provider is used in the performance of engagements that set out the responsibility of the engagement team when engaging a service provider, which may include responsibility for certain matters in paragraph 64.

A208. Obtaining an understanding of the service provider may include understanding the conditions of the service, for example, how often updates will be provided for an IT application, limitations on the use of the IT application and how the service provider addresses confidentiality of data. Paragraph 41(c)(iii) requires the firm to establish policies or procedures that address the nature, timing, extent and content of communication with the service provider, for example, information to support the firm’s understanding of the service provider and use of the resource (e.g., updates or changes to the resource or deficiencies in the resource).

A209. The firm’s responsibilities in using the service provider may include matters such as the actions the firm needs to take in order to implement the resource or information the firm needs to communicate to the service provider in order that the resource can function effectively. For example, in the case of an IT application, the firm may need to have appropriate supporting IT infrastructure and IT processes in place.

A210. In determining whether the resource is appropriate, the firm may make inquiries of the service provider or request documentation from the service provider about matters such as:

- For human resources, the qualifications, experience and location of the individuals, including professional licenses or membership obligations, and how they develop and maintain the appropriate competence to perform the services.

- For technological or intellectual resources, the procedures undertaken by the service provider in designing, implementing and operating the resources.

- How the service provider identifies and responds to changes that affect the resources, for example, changes in the professional standards or information that indicates a deficiency in the resources;

- How the resource will be evaluated, monitored or remediated by the service provider.
There may be circumstances when the service provider supplies the firm with an assurance report on the description and design of their controls over the resource, and in some circumstances, it may also include assurance on the operating effectiveness of such controls.

**Evaluating the System of Quality Management** (Ref: Para. 65A–65D)

A210A. In the context of this ISQM, it is intended that the operation of the system as a whole provides reasonable assurance that the objectives of the system are achieved. The evaluation undertaken by the individual(s) assigned ultimate responsibility and accountability for the system of quality management therefore determines whether the system is doing so. This ISQM does not require the firm to obtain an independence assurance report on its system of quality management.

A210B. Scalability examples to demonstrate how the information from the firm’s monitoring and remediation process may be obtained, generated or used:

- In a smaller firm, the individual(s) assigned ultimate responsibility and accountability for the system of quality management may be directly involved in the monitoring and remediation and will therefore be aware of the information that supports the evaluation of the system of quality management.
- In a larger firm, the firm may need to establish processes to collate, summarize and communicate the information needed to evaluate of the system of quality management.

A210C. Prompt and appropriate action when the evaluation indicates that the system does not provide reasonable assurance that the objectives of the system have been achieved may include:

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

A210D. Examples of circumstances when it may be appropriate for the firm to communicate to external parties: [To be further considered when information and communication component is revised]

- When the firm belongs to a network and the information is relevant to the network or other firms within the network who use the work performed by the firm, for example, in the case of a group audit.
- When a report issued by the firm is determined by the firm to be inappropriate as a result of the failure of the system of quality management, and management or those charged with governance of the entity need to be informed.
- When law or regulation requires the firm to communicate to an oversight authority or a regulatory body that the system does not provide reasonable assurance that the objectives of the system have been achieved.

**Performance Evaluations** (Ref: Para. 65D)

A210E. Periodic performance evaluations promote accountability. In considering the performance of individuals, the firm may take into account:
• The results of the firm’s monitoring activities for aspects of the system of quality management that relate to the responsibility of the individual. For example, the firm may set targets for the individual and measure the results of the firm’s monitoring activities against those targets.

• The actions taken by the individual(s) in response to identified deficiencies that relate to the responsibility of that individual, including the timeliness and effectiveness of such actions.

Scalability examples to demonstrate how the firm may undertake the performance evaluations:

• In a smaller firm, the firm may engage a service provider to perform the evaluation, or the results of the firm’s monitoring activities may provide an indication of the performance of the individual(s).

• In a larger firm, the performance evaluations may be undertaken by an independent non-executive member of the firm’s governing body, or a special committee overseen by the firm’s governing body.

A210F. A positive performance evaluation may be rewarded through compensation, promotion and other incentives that focus on the individual’s commitment to quality, and reinforce accountability. On the other hand, the firm may take corrective actions to address a negative performance evaluation that may affect the firm’s achievement of its quality objectives.

Public Sector Considerations

A210G. In the case of the public sector, it may not be practicable to perform a performance evaluation of the individual assigned ultimate responsibility and accountability for the system of quality management, or to take actions to address the results of the performance evaluation, given the nature of the individual’s appointment. Nevertheless, performance evaluations may still be undertaken for other individuals in the firm who are assigned operational responsibility for aspects of the system of quality management.

Documentation (Ref: Para. 66–69)

A211. Documentation provides evidence that the firm complies with this ISQM, as well as law, regulation or relevant ethical requirements. It may also be useful for training personnel, ensuring the retention of organizational knowledge and providing a history of the basis for decisions made by the firm about its system of quality management. It is neither necessary nor practicable for the firm to document every matter considered, or judgment made, about its system of quality management. Furthermore, compliance with this ISQM may be evidenced by the firm through its information and communication component, documents or other written materials, or IT applications that are integral to the components of the system of quality management.

A212. Documentation may take the form of formal written manuals, checklists and forms, may be informally documented (e.g., e-mail communication or postings on websites), or may be held in IT applications or other digital forms (e.g., in databases). Factors that may affect the firm’s judgments about the form, content and extent of documentation may include:

• The complexity of the firm and the number of offices;

• The nature and complexity of the firm’s practice and organization;

• The types of services the firm provides and the nature of the clients to whom services are
provided; and

- The nature and complexity of the matter being documented, for example, whether it relates to an aspect of the system of quality management that has changed or an area of greater quality risk.

In a smaller firm, it may not be necessary to have documentation supporting matters communicated because informal communication methods may be effective. Nevertheless, the firm may determine it appropriate to document such communications in order to provide evidence that they occurred.

A213. In some instances, an external oversight authority may establish documentation requirements, either formally or informally, for example, as a result of the outcome of external inspection findings. Relevant ethical requirements may also include specific requirements addressing documentation, for example, the IESBA Code requires documentation of particular matters, including certain situations related to conflicts of interest, non-compliance with laws and regulations and independence.

A214. In some circumstances, it may be appropriate for the firm to document its process and analyses for establishing the quality objectives, identifying and assessing quality risks and designing responses to such risks, to provide a history of the basis for decisions made by the firm about its system of quality management.