ED-ISQM 1 – Question 7: Firm governance and the responsibilities of leadership

Do the revisions to the standard appropriately address firm governance and the responsibilities of firm leadership? If not, what further enhancements are needed?

Q7 - Agree

3. National Auditing Standard Setters

Compagnie Nationale des Commissaires aux Comptes (CNCC) and the Conseil Supérieur de l'Ordre des Experts-Comptables (CSOEC)

We agree that the revisions to the standard appropriately address firm governance and the responsibilities of firm leadership. We refer to paragraphs 23 to 25.

Conselho Federal de Contabilidade - Federal Accounting Council (Brazil)

Yes. The ED addresses the governance and responsibilities to firm’s leadership in terms of principles.

Malaysian Institute of Accountants - Auditing and Assurance Standards Board

The revisions in the standard dealing with governance and responsibilities are addressed appropriately.

4. Accounting Firms

CAS International

Yes, we agree.

Crowe Global

The revisions to the standard appropriately address firm governance and the responsibilities of firm leadership. Including firm governance is a welcome improvement from ISQC 1, and we agree with the IAASB’s view about the “paramount importance” of governance and leadership. We agree that the requirements of this component are universally applicable, but there are practical challenges.

Deloitte Touche Tohmatsu Limited

In recognition of its paramount importance to engagement quality and to establishing the environment in which the system of quality management operates, DTTL is supportive of the IAASB’s focus on firm governance and leadership and believes that the revisions to the standard appropriately address the responsibilities in this area.

Duncan and Topliss

R7: There are numerous references to the firm’s management being those that have to understand the standard and take the lead / responsibility for the standard being implemented and maintained. There are no further enhancements suggested at this stage.

ETY Global

Yes, they do.
Haysmacintyre LLP

Yes

KPMG IFRG Limited

We believe the ED is clear that responsibility lies with the Senior Leadership of the audit firms. We also believe it is clear that operational responsibility may be delegated, however ultimate responsibility and accountability for the SoQM is retained by Senior Leadership. We are supportive of the enhancements made in the ED as it drives a focus on accountability and achieving the correct quality focused mindset.

Mazars

Yes, these appear appropriate.

Mazars USA LLP

ED-ISQM 1 appropriately addresses firm governance and the responsibility of firm leadership.

MNP LLP

Yes, the standard appropriately addresses firm governance.

Moore Stephens International

They do

Nexia International

YES

5. Public Sector Organizations

Auditor General South Africa

Yes, the revisions to the standard appropriately address firm governance and the responsibilities of firm leadership.

Australasian Council of Auditors General

Yes, there is an appropriate level of focus on leadership and governance.

National Audit Office of Malta

Yes.

Office of the Auditor General New Zealand

For the Office of the Auditor-General in New Zealand, the Auditor-General has ultimate responsibility and accountability for the system of quality management (ED-ISQM-1 paragraph 24). As the Auditor-General is a statutory appointment and reports to Parliament the requirement for periodic performance evaluations per ED-ISQM paragraph 24 (b) is not applicable. Paragraph 21 of ED-ISQM permits requirements to be not applied when they are not relevant to the circumstances of the firm. We would therefore not apply 24(b).
We believe the proposed standard appropriately addresses firm governance and the responsibilities of firm leadership.

**Office of the Auditor General of Canada**
Yes, the revisions to the standard appropriately address firm governance and the responsibilities of firm leadership.

**Provincial Auditor Saskatchewan (1)**
Yes, the revisions to the standard appropriately address firm governance and the responsibilities of firm leadership.

**US Government Accountability Office**
We believe that ED-ISQM 1 appropriately addresses firm governance and the responsibilities of firm leadership.

**6. Member Bodies and Other Professional Organizations**

**CA Ireland**
Yes, we believe that the standard appropriately addresses firm governance and the responsibilities of firm leadership.

**California Society of CPA’s**
Yes.

**Center for Audit Quality**
We support the revisions to the standard related to this component.

**Consiglio Nazionale dei Dottori Commercialisti e degli Esperti Contabili (CNDCEC)**
According to CNDCEC, ISQC 1 revisions on responsibilities of firm leadership are appropriate to strengthen the importance of this key element within the new system of quality management.

**Illinois CPA Society**
Yes, we believe the standard appropriately addresses firm governance. Tone at the top is critical to establishing a quality governance and leadership component in a quality management system.

**Institute of Chartered Accountants of Pakistan**
We recognise that firm’s leadership is responsible for firm’s governance. The increased emphasis on leadership responsibility and governance in the proposed standard are appropriate.

**Institute of Chartered Accountants of Scotland (ICAS)**
We believe that the revisions to the standards appropriately address firm governance and the responsibilities of firm leadership.
Institute of Independent Auditors of Brazil (IBRACON)
Yes. We believe the principle of leadership relates to the ability of the firm to set the tone from the top by clearly communicating the strategy, culture, values and expected behavior, and by demonstrating how these are embedded throughout the firm. Setting this component as the first one highlights its importance.

Instituto de Censores Jurados de Cuentas de España
We believe that governance and leadership responsibilities have been properly addressed and leadership and governance objectives adequately set.

- Culture and promotion of the values of the firm.
- Leader responsibilities.
- Strategic decisions in which quality is first considered, before other considerations.
- Adequate and flexible structure of the organisation with functions to ensure quality management and that is adaptable to the circumstances and engagements of every firm.
- Adequate organisation of resources broadly considered.
- Regular performance evaluations.
- Promotion of a commitment to quality through the establishment of a complaints and allegations channel.

The tone and attitude at the top of the organisation towards the quality has also been highlighted. (Para A27)

Royal Institute of Chartered Surveyors
Yes, we believe the requirement of assigning responsibility and accountability for the system of quality management to an individual or a certain group of individuals at a firm to demonstrate a commitment to quality will appropriately address firm governance and leadership.

Q7 - Agree but with further comments

1. Monitoring Group

Basel Committee on Banking Supervision
The Committee is supportive of the IAASB’s approach and, in particular, of the following features:

- A focus on an audit firm’s governance and leadership, including accountability and an objective recognising the audit firm’s role in serving the public interest (ED-ISQM1 paragraph 23).

ED-ISQM 1: governance and leadership

Paragraph 24(b) requires the firm to establish policies and procedures for the periodic performance of individuals. It does not set out minimum requirements that should be included in those policies and procedures. Paragraph A40 indicates the policies and procedures may include the results of monitoring activities and the action taken by individuals in response to identified deficiencies relating to the responsibility of that individual.

We believe the matters in paragraph A40 should be elevated to be requirements in the standard, as they are necessary to promote audit quality, and so should be included in paragraph 24(b).
ED-ISQM 1: culture

The draft standard applies to audit firms performing audits or reviews of the financial statements or other assurance or related services (paragraph 4). “Audit firms” are often multi-disciplinary firms, where ISQM 1 services form a minority of the total fees and where partners who are not auditors may be leaders.

It would seem relevant when looking at aspects of culture and leadership, for example, to consider how the culture in relation to audit services might be impacted by the culture of the firm as a whole, and how that might be addressed. There is no guidance for these circumstances.

International Forum of Independent Audit Regulators

We strongly support the IAASB’s development of proposals to address firms’ quality control systems and to strengthen the engagement quality review standard. We have identified the following areas where substantive improvements have been made to the extant standards:

ISQM 1

- Enhancements to Governance and Leadership that reinforce that the firm’s leadership collectively has the responsibility and accountability for setting and demonstrating the firm’s culture and values;
- Establishment of requirements relating to resources (including, but not limited to, personnel), networks and service providers. These improvements are required to respond to the evolution of the audit industry, including how firms are responding to environmental changes in order to provide services effectively and achieve the appropriate levels of quality;
- Expanded scope of engagements requiring engagement quality reviews;

We support the enhanced requirements relating to governance and leadership, and also recognise the benefits of enhanced requirements relating to communication and monitoring and remediation. We suggest that an objective be developed in relation to the oversight by the firm’s leadership of matters arising from other elements of the standard (further to the periodic assessment in paragraph 55), in particular the communication and monitoring and remediation elements. This could be the driver to enable the firm’s leadership to proactively identify quality matters and intervene at the appropriate stage to prevent quality risks from materializing or minimizing their impact.

2. Regulators and Audit Oversight Authorities

Committee of European Auditing Oversight Bodies

12. We believe that learning and improving is not sufficiently included in the proposed standard. Whilst the proposals do include many welcome provisions regarding monitoring, the element of learning and improvements can be further elaborated upon. In our view, the ability to learn from mistakes and errors is an essential element of quality management. A learning/improvement-oriented environment has certain cultural requirements and behavioural aspects to it, which are not addressed in the current ED. We suggest including provisions on this.

16. We are supportive of the concept of quality objectives, and their adaptability so as to reflect, amongst other factors, a firm’s size, complexity, structure, legal form and client base. As noted in paragraph 4 of this letter, we suggest including some of the provisions regarding scalability, which are currently part of the introductory paragraphs of the exposure draft, in the requirements section of the standard so as to better explain how the quality objectives, scalability and the risk approach are to be applied in practice and how
factors such as size, complexity, structure, legal form and client base will impact a firm’s quality management system. Additionally, as noted above, we think it is important for the standard to also address the need to learn from mistakes and errors and as a consequence we suggest adding an quality objective to ‘be a learning organization’, including the necessary requirements about an open culture and others as appropriate.

18. We suggest including provisions aimed at creating a learning environment whereby auditors’ experiences are evaluated and learned from. In that regard, we feel that tone-at-the-top should be expanded towards an integrated approach of culture and behaviour at all levels in the organization including appropriate behaviour (often described as ‘practice what you preach’).

Financial Reporting Council United Kingdom

We strongly support the revisions to the standard in respect of firm governance and the responsibilities of firm leadership. As explained in our response to the ITC, firm leadership collectively has the responsibility and accountability for modelling and articulating the audit firm’s culture and values, demanding the highest standards of ethical behaviour throughout the firm, encouraging transparency, and a willingness to challenge and make difficult decisions to maintain the firm’s culture and values. Audit firm governance is therefore a critical component of quality; at the core of a QMA and foundational to its effectiveness. In particular:

- We strongly support the introduction of the quality objective that addresses the firm’s role in serving the public interest. The firm’s overriding responsibility is to act in the public interest. As noted earlier, we believe this overriding responsibility should feature in the overall objective of ISQM1.

- We strongly support the emphasis on a culture of quality, including recognising and reinforcing the importance of professional ethics, values and attitudes throughout the firm. In our view quality, and the associated professional behaviours, is the responsibility of all personnel within the firm and firm leadership are accountable for embedding that culture.

- We agree, consistent with ISQC1, that the individuals assigned ultimate responsibility and accountability, and if relevant the individuals assigned operational responsibility, for the firm’s system of quality management, should have an understanding of the ISQM (paragraph 20). We do not agree with the condition “relevant to their responsibilities”, as all the text of the ISQM, in our view, is relevant to their understanding of the responsibility for the firm’s system of quality management. In particular, paragraph 24(a)(i) requires those with ultimate responsibility and accountability to have the appropriate experience and knowledge to fulfill the assigned responsibility. Such knowledge would undoubtedly include the text in ISQM1. We believe this is always relevant regardless of the size or structure of the firm.

- We agree with the IAASB that the quality objectives in the governance and leadership component are universally applicable to firms of all sizes, particularly as the quality objectives have been established as outcomes.

Independent Regulatory Board for Auditors (South Africa)

A foundation of success in quality management is the role of firm leadership, with the tone at the top being critical in achieving improved audit quality through the successful implementation of a system of quality management.
Recent inspections findings have arisen across the entire spectrum of ISQC 1 elements. These findings, most of which relate to engagement performance, speak directly to the inadequate establishment of policies and procedures designed to promote an internal culture that recognises quality as essential when performing audit engagements. The significant findings have a direct bearing on leadership’s tone at the top in driving a culture of consistent, sustainable high audit quality within the firm. Recurring inspection findings indicate that firm leadership is not sufficiently promoting a quality-orientated internal culture or fulfilling its responsibilities to ensure quality within the firms, in some cases. These recurring findings do not only occur on follow-up visits to firms and engagement partners, but have also been observed on new inspections of different engagement partners within firms that were not previously inspected. This indicates that the tone at the top is not adequately promoting quality.

Although we agree that the revisions to the standard progressively address firm governance and the responsibilities of firm leadership, we encourage the IAASB to consider the following points:

Could a non-practitioner CEO for a firm performing audits be this individual? As an audit regulator, we have raised concerns with firms where the CEO is not a practitioner. An audit regulator’s mandate may not extend to non-practitioners. Also, how would the firm demonstrate that the individual has the required understanding, if the individual is not a practitioner?

Who could be regarded as an “equivalent” of the CEO or managing partner?

Delegation of the operational implementation of the system of quality management should not result in the reassignment of responsibility and accountability.

SMPs have raised the concern that, as ED-ISQM 1 requires the firm to assign ultimate responsibility and accountability for the system of quality management to the firm’s chief executive officer or its managing partner (or equivalent) or, if appropriate, the managing board of partners (or equivalent) (paragraph 24(a) of ED-ISQM 1), in other words, to an individual or individuals, a practical problem exists where a very small firm may have only a handful of partners or a sole practitioner. We therefore suggest that this requirement be conditional, i.e. that scalability be introduced here. Although paragraph A32 includes guidance on firms of various sizes, the paragraph could include more clarity on scalability.

We encourage the IAASB to include a requirement for firms to include engagement quality as a key performance indicator in the performance evaluation of all engagement partners and engagement teams, with an appropriate weighting for quality. Such a requirement is included in paragraph 24(b) of ED-ISQM 1, but does not apply to all partners and engagement teams.

We have advocated in our various publications, and as part of the IRBA’s restoring confidence strategy, that a key component of quality management is firm leadership, and that leadership commitment leads to improvements in audit quality. We therefore support the central role assigned to firm leadership in the proposed quality management standards.

**Irish Auditing and Accounting Supervisory Authority**

We are supportive of the concept of quality objectives, and their adaptability so as to reflect, amongst other factors, a firm’s size, complexity, structure, legal form and client base. As noted in paragraph 4 of this letter, we suggest including some of the provisions regarding scalability, which are currently part of the introductory paragraphs, in the requirements section of the standard so as to better explain how the quality objectives, scalability and risk approach are to be applied in practice and how factors such as size, complexity, structure, legal form and client base will impact a firm’s quality management system. Additionally, as noted above, we think it is important for the standard to address the need to learn from
mistakes and errors and suggest adding a quality objective to ‘be a learning organisation’, including the necessary requirements regarding an open culture and others as appropriate.

We believe that learning and improving is not sufficiently reflected in the proposed standard. Whilst the proposals include many welcome provisions regarding monitoring, the element of learning and improvement can be further elaborated upon. In our view, the ability to learn from mistakes and errors is an essential element of quality management. A learning/improvement-oriented environment has certain cultural requirements and behavioural aspects to it, which are not addressed in the current exposure draft (ED). We suggest including provisions on this.

We suggest including provisions aimed at creating a learning environment whereby auditors’ experiences are evaluated and learned from. In that regard, we feel that tone-at-the-top should be expanded towards an integrated approach of culture and behaviour at all levels in the organisation including appropriate behaviour (often described as ‘practice what you preach’).

**National Association of State Boards of Accountancy**

In general, we believe that the proposals generate benefits for engagement quality. We have concern as to whether there is enough guidance provided to establish a strong culture at the firm level to have a focus on quality management. We recommend expanding the guidance in the governance and leadership section.

Yes, we believe that the revisions to the standard appropriately address firm governance and the responsibilities of firm leadership.

**3. National Auditing Standard Setters**

**AICPA**

Yes. However, many SMPs will need to develop more formal documentation about this component, which will take time and require implementation support.

**Australian Auditing and Assurance Standards Board**

The AUASB is supportive of ISQM 1 addressing leadership and governance and agree with the principles of the importance of ‘tone from the top’. However, to reiterate the comments under 1(a) above, the requirements of the proposed standard need to be principles-based and not become prescriptive on how firms manage their businesses. A risk-based approach facilitates firms identifying their own quality objectives, quality risks and responses to address those risks. The AUASB does not consider that it is the role of the standards to prescribe audit firm governance.

An example of the level of granularity is in relation to paragraph 23(a), firm culture, where the AUASB considers that in practice it will be challenging to document the culture of the firm in order to meet the requirements of the standard.

**Canadian Auditing and Assurance Standards Board**

Refer to our response to Question 1(c).

In addition, we heard from some Canadian stakeholders whose firm’s leadership team is comprised of tax practitioners, who may not have knowledge of assurance standards that it may be difficult for the firm to identify an individual with appropriate experience and knowledge to fulfill the responsibilities.
To achieve scalability of this requirement (per our response to Question 1(c)) and to avoid complications when the firm’s leadership team is not comprised of assurance practitioners), we suggest that the requirement be simply to assign responsibility and accountability for the system of quality management, with the detail that follows, which is very prescriptive, moved to application material, as demonstrated below:

(a) Assigning ultimate responsibility and accountability for the system of quality management to an appropriate individual(s) in the firm.

AM Depending on the nature and circumstances of the firm, the appropriate individual(s) assigned ultimate responsibility and accountability for the system of quality management may be:

- the firm’s chief executive officer; or
- the firm’s managing partner (or equivalent); if appropriate,
- the firm’s managing board of partners (or equivalent); or
- a group of partners.

AM In identifying the individual(s) to whom such responsibility and accountability is assigned, the firm may consider the following factors shall:

(i) Whether the individual(s) has Have the appropriate experience and knowledge to fulfill the assigned responsibility.

(ii) Whether the individual(s) demonstrates a commitment to quality through their actions and behaviors, including recognizing and reinforcing the importance of professional ethics, values and attitudes, and establishing the expected behavior of personnel relating to the performance of engagements and activities within the system of quality management.

AM (iii) Depending on the nature and circumstances of the firm, the firm also may establish structures, reporting lines, and appropriate authorities and responsibilities, including assigning operational responsibility for the following matters to personnel who fulfill the requirements in paragraph 25:

a. The system of quality management as a whole; and

b. Specific aspects of the system of quality management, as appropriate to the nature and circumstances of the firm, which shall include operational responsibility for compliance with independence requirements and the monitoring and remediation process.

Hong Kong Institute of Certified Public Accountants

In general, we consider the revisions to the standard appropriately address firm governance and the responsibilities of firm leadership which emphasize the responsibility of firm leadership to proactively managing quality.

However, we would suggest IAASB to set out the frequency and timing for periodic “performance evaluations” of the individual(s) assigned with ultimate responsibility and accountability for the system of quality management in paragraph 24(b) to conform with the annual evaluation requirement of quality management system in paragraph 56.

Japanese Institute of CPAs

Paragraph 23(c)
Paragraph 23(c) states that “the firm’s strategic decisions and actions, including financial and operational priorities, demonstrate a commitment to quality and to the firm’s role in serving the public interest, by consistently performing quality engagements.” We suggest that the requirements for quality objectives be divided between “commitment to quality” and “commitment to the firm’s role in serving the public interest.”

Paragraphs 23(c) and (e) and paragraph 38 (Quality objectives for resources)

Resources are addressed in paragraphs 23(c) and (e) (governance and leadership) and paragraph 38 (resources). We believe it is necessary to clarify the distinction and relationships of these requirements.

We believe that the revisions to the standard appropriately address firm governance and the responsibilities of firm leadership.

**Kammer der Steuerberater und Wirtschaftsprüfer**

Yes, however guidance is missing on actions which should be taken if the responsibility is not fulfilled (such as ongoing negative results in monitoring activities, lack in tone at the top, …). Application Guidance A123 contains guidance on actions to be taken for personnel who demonstrates actions or behaviors that negatively affect quality, similar guidance should be included if persons with the ultimate responsibility and accountability for the system of quality management demonstrate actions or behaviors that negatively affect quality.

**New Zealand Auditing and Assurance Standards Board**

The NZAuASB is supportive of expanding the requirements to address the “tone at the top” as part of the firm’s system of quality management. However, it is not the role of the standards to prescribe audit firm governance. The NZAuASB cautions against the use of prescription which could be seen to be “telling” firms how to run their business. Trying to define requirements for good governance may also stray outside the mandate of the IAASB and a national standard setting body.

As highlighted above, the NZAuASB has heard that the requirement for periodic performance evaluations of the individual assigned ultimate responsibility and accountability may be challenging in practice. We consider this requirement may also stray into prescribing firms how to manage their human resources. Some firms, especially SMPs, may find it challenging to find the appropriate person to perform such an evaluation. To be meaningful, the evaluator would need to be independent, have the appropriate authority and be well respected to be able to challenge the firm’s leadership, and have access to criteria against which such an evaluation would be made. In principle, we think this should be left to the firm to manage as appropriate to its circumstances.

This should be less challenging for larger firms, including those within a network, where such reviews may already occur in practice. For an SMP (especially a sole practitioner), the requirement may be more challenging to apply. We think it likely that liability and other risks may deter practitioners from other firms to perform the role (for example through “peer reviews”); current experience in the New Zealand environment supports this concern.

The NZAuASB also questions whether it is appropriate to guide a firm’s performance evaluation policies by highlighting compensation, promotion and other incentives. Measuring good quality is, of course, difficult and we do not think that establishing a link between compensation and quality will necessarily enhance audit quality. One may readily identify the exceptions (e.g., a poor result from a regulatory review, or an independence breach) and penalise a partner for poor performance. However, that may not in itself
incentivise or promote good quality. Instead, it may focus behaviour on avoiding being penalised and have the unintended consequences of a focus on compliance rather than quality.

In practice, we think it may also be challenging to document the culture of the firm in order to meet the documentation requirements of the standard.

4. Accounting Firms

BDO International

We also note that it might help to be more explicit about ‘who’ is responsible for the risk identification and assessment process.

With respect to the quality objectives outlined in paragraphs 23, 32, 34, 36, 38, 40 and 42 of ED-ISQM 1, we are broadly supportive of the nature and extent of these objectives – recognising that they are designed to be outcome-based with the ability of the firm to determine how they may be achieved. While we support the emphasis placed on culture, leadership and assignment of roles in other requirements, we note that these are all described in terms of ‘the firm’ within paragraph 23. This could give the impression that leadership qualities at the engagement level are not as important in driving quality.

Yes, we are generally supportive of the quality objectives relating to firm governance and the responsibilities of firm leadership. We believe that by specifically addressing firm governance – in contrast to extant ISQC 1 - this ensures that ED-ISQM 1 provides sufficient prominence to this critical aspect of quality management.

We believe that as currently constructed, the requirements set out in ED-ISQM 1 are relatively clear and allow flexibility for firms to determine how their system of quality management can meet the objective. In addition, we support the prioritisation accorded to this specific component - as the first of the eight components and the overriding emphasis to consider impact that the tone at the top of a firm (or an engagement) might have through cultural, ethical or decision-making influences. We also note, and support, inclusion of the impact of a firm’s strategic actions (including financial and operational decisions). This inclusion is particularly important from a public interest perspective.

However, we feel that additional guidance relating to the following may assist users:

Scalability: although there are some example situations in the ED relating to small firms (e.g. paragraphs A28, A32, A37, A42), the examples are quite brief and additional guidance is needed. Further, the separate document on Draft Examples is a good start in demonstrating scalability but we believe that more than three scenarios are needed.

Roles and responsibilities: It may be helpful, perhaps as part of further FAQ development, to provide examples of a range of different scenarios when individuals have ultimate responsibility as compared to operational responsibilities.

EY Global Limited

We agree with incorporating leadership accountability into the standard and that leadership is responsible and accountable for the system of quality management that supports the consistent performance of quality engagements. However, we believe the requirement in ED-ISQM 1 is overly prescriptive as to who can have ultimate responsibility for the firm’s system of quality management. Our recommendation in our response to Q7 in ‘Appendix 1 EYG Response to ED-ISQM 1’ is to expand who can have ultimate responsibility to provide firms with greater flexibility to place ultimate responsibility and accountability with individuals who
should have that responsibility based on the governance structure of the firm and consistent with the intentions of the standard.

We also agree with incorporating formal leadership accountability for quality into ED-ISQM 1 and the proposed enhancements to the expectations for a firm-wide culture of quality enhances firms’ management of engagement quality. Instilling responsibility for quality in firm leadership and governance is, in our view, fundamental to improving quality.

We understand the need for changes in the area of governance and leadership compared to ISQC 1. As noted above in Q1, instilling responsibility for quality into firm leadership and governance is fundamental to improving quality. However, the requirement in ED-ISQM 1 limits who can have ultimate responsibility 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). As noted in our response to Q6(d), we believe that the required responses in the proposed standard should be limited to as few as possible and be principles-based so that firms design and implement responses specific to the nature and circumstances of the firm; therefore, the requirement as to who can have ultimate responsibility should also be principles-based so that firms identify the person with the appropriate authority for the system for quality management.

It is not possible for the standard to address all possible legal and operational structures of firms. Our recommendation is for the required response in paragraph 24(a) to be updated as follows: “Assigning 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) or an individual with equivalent authority, competence and responsibility consistent with the governance structure of a particular firm.” Expanding who can have ultimate responsibility will provide firms with the flexibility to better align what is being required by ED-ISQM 1 with the operations of their organization so that the person assigned this role is ultimately responsible and accountable for the system of quality management, including performing the annual evaluation.

Grant Thornton International Limited

Governance and leadership – paragraph 23(a) requires firms to establish 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, including the firm’s culture, and specifically that the culture promotes a commitment to quality. Further guidance in this area would be helpful, specific to how a firm would both design such a culture and evidence that this culture is in place.

Governance and leadership – paragraph 24(a)(i) requires the individual assigned ultimate responsibility and accountability for the firm’s system of quality management to have the appropriate experience and knowledge to fulfill the assigned responsibility. Further guidance on what is meant by “appropriate experience and knowledge” would be helpful. For example, does this mean that the individual should possess qualifications in audit, and as such an advisory or tax partner would unlikely be able to fulfil this role, or that the individual should have experience and knowledge in managing a business.

We are generally supportive of the revisions to the standard to address the responsibilities of firm leadership. However, we would make the following observations in relation to this component:

Paragraph 24(a) requires that ultimate responsibility and accountability for the system of quality management is assigned to the firm’s chief executive officer (or equivalent) who has the appropriate experience and knowledge to fulfil the assigned responsibility. As noted in our response to question 3 above, further guidance is required on what is meant by “knowledge and experience.” Firms may have chief
executive officers (or equivalent) that are from parts of the practice other than audit and assurance, for example from the advisory or tax practices, and it is unclear whether this requirement is intending to prohibit such individuals from fulfilling the role of chief executive officer (or equivalent).

Paragraph 20 requires the individual(s) assigned ultimate responsibility and accountability and the individual(s) assigned operational responsibility for the firm's system of quality management to have an understanding of the proposed standard relevant to their responsibilities. We question whether this requirement should be extended to have an understanding of the entire standard, as is currently required by extant ISQC 1, paragraph 13. Absent an understanding of the entire standard we question how these individuals would identify what is or is not relevant to their responsibilities.

Also as noted in our response to question 3, in relation to paragraph 23(a), further guidance on how a firm would design and evidence the culture required would be helpful.

**Kreston International**

Goverance and firm leadership are appropriately addressed.

Assessment of the managing partner or quality partner will be difficult in a small partnership or where there is significant ownership by one individual and guidance on addressing this issue could be helpful.

**MGI Worldwide**

Yes, whilst it is clear that the “tone at the top” remains key to the overall direction and culture of quality within a firm, the draft standard allows for delegation of individual roles and responsibilities (reporting up to the person with ultimate responsibility) which could encourage involvement across the firm, embedding that commitment to quality throughout (paragraph 24(a)iii).

The requirement to evaluate the performance of those undertaking leadership roles may be difficult in SMPs, especially where there is only be one principal/partner (paragraph 24(b)). A42 recognises this and states that the results of any monitoring activities that are performed by, say service providers, can be considered here. This may place an expectation on such firms to have external assessments/reviews from service providers/independent parties at increased cost to the firm.

In the application material, paragraph A41 indicates that a “firm may take corrective actions to address a negative performance evaluation that may affect the firm’s achievement of its quality objectives” (our emphasis). As the standard’s aim is to help firms improve engagement quality, we consider there should be a requirement to take corrective actions in such cases. The extent of those actions would be determined by the firm but indications of potential deficiencies in quality management should be robustly dealt with.

**Nexia Smith & Williamson**

We agree in general with the revisions to the standard.

We believe that it would be helpful to clarify the level of “firm leadership” to which the requirements apply in firms where the strategy and management of the audit business is delegated to a separate board or committee.

**PKF International Limited**

In our view the revisions to the standard appropriately address firm governance and the responsibilities of firm leadership.
However, the standard contains inconsistencies in its requirements for periodic performance evaluations for those with ultimate and operational responsibility for the firm’s system of quality management, specifically in context of an SMP firm. For example, in paragraph 24 (b) of ED-ISQM 1 there is a required response that a firm shall establish policies and procedures over the process for such an evaluation, without any exemptions from these requirements for a smaller firm. But the related application guidance in paragraph A42 of EDISQM 1 indicates that the results of a firm’s monitoring process may provide an indication of the performance of those with ultimate and operational responsibility for the firm’s system of quality management, where it is impractical to conduct performance evaluations.

The use of the word “may” in paragraph A42 of ED-ISQM 1 versus “shall” in paragraph 24 (b) of ED-ISQM 1, could lead to diverging views on how formalized an SMP’s performance evaluation process should be for those with ultimate and operational responsibility for the system of quality management.

**PKF South Africa**

The revisions to the standard appropriately address firm governance and the responsibilities of firm leadership.

However, the standard contains inconsistencies in its requirements for periodic performance evaluations for those with ultimate and operational responsibility for the firm’s system of quality management, specifically in context of an SMP firm. For example, in paragraph 24 (b) of ED-ISQM 1 there is a required response that a firm shall establish policies and procedures over the process for such an evaluation, without any exemptions from these requirements for a small firm. But the related application guidance in paragraph A42 of ED ISQM 1 indicates that the results of a firm’s monitoring process may provide an indication of the performance of those with ultimate and operational responsibility for the firm’s system of quality management, where it is impractical to perform performance evaluations.

The use of the word “may” in paragraph A42 of ED-ISQM 1 versus “shall” in paragraph 24 (b) of ED-ISQM 1, could lead to diverging views on how formalised an SMP’s performance evaluation process should be for those with ultimate and operational responsibility for the system of quality management.

**PriceWaterhouseCoopers**

The ED appropriately recognises the importance of governance and leadership, including establishing an appropriate tone at the top, and responsibility for delivering key messaging relating to quality to staff.

The requirements strike an appropriate balance between setting out principles and expectations of firm leadership, and detailed requirements, recognising that different jurisdiction legal or regulatory requirements may exist relating to audit firm governance.

As a matter of providing a logical flow to the standard, it may be more appropriate to include the firm’s risk assessment process, which explains the role of quality objectives, risks and responses, prior to the governance and leadership component. While we recognise the importance of the role of the governance and leadership component with respect to the oversight of the SoQM, in our view reordering these components may aid understanding.

With respect to paragraph 24(a), we agree that an individual with ultimate responsibility for the SoQM needs to be appointed and that in many cases this may be the firm’s senior partner or managing board.
In many firms, there may be a senior Assurance partner, or Assurance Board, that, in light of the firm’s structure, might be assigned ultimate responsibility for the firm’s SoQM in accordance with ISQM 1. It would be useful to reflect this in the language of paragraph 24(a) and paragraph A36.

We recommend recognising that in many firms’ structures there may be a senior Assurance partner or Assurance Board that, in light of the firm’s structure, might be assigned ultimate responsibility for the firm’s SoQM in accordance with ISQM 1.

**Paragraph A42 Performance Evaluations:**

- We suggest adding that the performance evaluation of the individual assigned ultimate responsibility for the firm’s system of quality management may also be a network service in some networks.

**RSM International Limited**

Yes these are addressed. However, we believe that further clarity is needed between the requirements in paragraph 24(b) and the guidance in A42. Paragraph 24(b) establishes requirements for periodic performance evaluations of the individuals assigned ultimate responsibility for the firm’s system of quality management, whereas the guidance in A42 recognizes this may not be practical in smaller firms. This discrepancy could be open to Regulator challenge if smaller firms determined not to carry-out performance evaluations. We recommend the application to smaller firms should be made clear in paragraph 24(b).

**5. Public Sector Organizations**

**International Organization of Supreme Audit Institutions**

Yes, the standard provides sufficient enhancements in this respect, compared to the previous version.

However, public sector institutions might face difficulties in performing regular performance evaluations of leadership, when they are ‘publicly’ or even ‘politically’ appointed. And who would do it if they are the head of the organisation?

**Office of the Auditor General of Alberta**

Preparing all members of governance and leadership of his or her responsibility for “the system of quality management” (paragraph 24 (a)). All members of the “firms managing board” may not have a background in assurance or be as experienced in quality management; therefore, some individuals may require significantly more time to become knowledgeable with their responsibilities.

Yes – we agree with the responsibilities of firm leadership and firm governance.

**Swedish National Audit Office**

In addition we would like to emphasize the importance of the leadership responsibility to ensure that professional skepticism is applied in all aspects of the audit.
6. Member Bodies and Other Professional Organizations

Accountancy Europe

Yes, we agree. We think though that there would be merit in recognising the interdependency between the firm responsibility and the engagement partner responsibility. We refer to our letter responding to ED-ISA 220 in this context.

Australian Accounting Professional and Ethics Standards Board

Subject to APESB’s significant concerns about the current form, scalability and prescriptive nature of the proposed ED-ISQM 1, we support the increased emphasis on leadership responsibility and governance in the proposed standard.

Subject to APESB’s significant concerns about the current form, scalability and prescriptive nature of the proposed ED-ISQM 1, we support the requirement for firm’s to assign ultimate responsibility and accountability for the system of quality management to the CEO, managing partner or managing board of partners. APESB supports the ability for the person(s) with ultimate responsibility and accountability to assign operational responsibility for the system of quality management to other individuals where appropriate. However, APESB is of the view that requiring firms to assign specific aspects, including compliance with independence requirements and the monitoring and remediation process, is too prescriptive. Firms should be able to use professional judgement to determine how responsibility for aspects of the system are to be assigned or delegated.

Chartered Accountants Australian and New Zealand and ACCA

We found that the revisions to the standard appropriately address leadership and governance; however, the requirements need to be principles-based and not become prescriptive on how firms manage their businesses. There is the risk that overly prescriptive requirements may inadvertently drive incorrect behaviours and therefore it should be for the firms to determine how to implement the principles in their particular circumstances and culture.

There are challenges around the assignment of individuals for ultimate responsibility and the subsequent evaluation of those individuals, particularly in the case of SMPs.

CPA Australia

In addition, as with our answer to question 8(a), we do not think it is necessary to specify that responsibility for the system of quality management for the entire firm needs to fall to one individual. Whilst many firms may allocate responsibility onto one individual, we do not consider it necessary to require firms to do so, as whether this is reasonable will depend on the firm’s structure. For example, a firm encompassing offices across an entire jurisdiction, rather than an individual office, may prefer to delegate that role on a different basis such as at the office or region level.

Yes, the standard communicates the responsibilities and accountability of senior leadership and the onus on the firm to take responsibility for quality management, although it does reflect a large firm’s perspective.

IFAC Small and Medicum Practices Committee

Although the standard does address firm’s governance and the responsibilities of firm leadership at an appropriate level, the ED seems based on a larger practice scenario and thus, many SMPs will struggle to identify with the degree of detail and have issues with the practical application. For example, in a small firm,
the act of responsibility assignment required by para 24(a) may be achieved by relatively informal means whereas holding them to account using periodic performance evaluations (para 24(b)) could be seen as being a mere compliance act (i.e., form over substance). In such cases, the day to day observations and actions of fellow partner(s) should adequately serve as a reprimand if the individual continues to demonstrate substandard behavior over time.

The overall observation is that this component is also too granular for firms with very few partners. It is not unusual for a single partner to be responsible for ALL roles and responsibilities within this component.

In other instances, the quality objectives are far too granular for smaller firms. For example, within the governance and leadership component in para 24(a)(iii), the firm is required to establish structures, reporting lines and appropriate authority for the system of QM as a whole. This objective is difficult to apply in a very small practice environment and is not applicable for a sole practitioner. A suggestion is to move some of the detail in the requirement to the application material if it was to be maintained.

Institut des Experts-comptables et des Conseils Fiscaux – Instituut Van de Accountants en de Belastingconsulenten (IAB-IEC)

In the redraft of this standard, the situation of the sole practitioner or the SMP with only a managing partner should be more coherent. In the current draft, the requirements or references are to be found in different paragraphs. They should be grouped together in a single section.

Institute of Chartered Accountants in England and Wales

We note in our main points above and elsewhere in this response the strongly held belief among some commentators that risk assessment is less a component, and more an overarching process. Mixed views have been expressed regarding the governance and leadership component, particularly as they apply to smaller firms which do not routinely use this sort of language. Again, examples would help.

Institute of CPAs of Uganda

ICPAU believes that the revisions to the standard appropriately address firm governance and the responsibilities of firm leadership. However, as the Board notes in Para 45 of ED-ISQM 1 the concerns that small and medium practices may experience practical challenges in implementing certain proposals related to governance and leadership, ICPAU recommends for clear guidance by the Board on how small and medium practices largely in the developing world can implement an effective governance process to their single-person firms.

We also wish to draw the Board’s attention to recent audit failures and governance issues identified at some firms and as such we invite the Board to think deeply whether the governance measures addressed in this ED-ISQM 1 will appropriately overcome and/or mitigate these failures.

Malaysian Institute of CPAs

Yes

The proposal to have someone operationally responsible for the implementation of the ISQM alludes to the concept of ‘tone at the middle’. If this is the case, the proposed ISQM 1 could be clarified to ensure that the responsibility cannot only be solely belonging to one individual or one department, but rather in the context of the entire firm’s system of quality management.
New York State Society of CPAs

Response: We believe that, subject to our reservations set forth in our response to question 2) above, the revisions to the proposed standard appropriately address firm governance and the responsibilities of firm leadership.

We believe that the proposed requirement of paragraph 24(b) to have performance evaluations of the individual(s) assigned ultimate responsibility and accountability for the firm's system of quality management is important but that it will create challenges for meaningful implementation. The internal politics of evaluating the CEO or equivalent is difficult. This challenge is recognized in paragraph A(42) effectively permitting the assessment for many SMPs to be limited to that implied by the evaluation of the quality management system as a whole. Our concern lies in that many larger organizations that would not fall under the paragraph A(42) exception would document pro forma compliance that is not, in fact, robust.

Nordic Federation of Public Accountants

Yes, we believe it does address the firm's governance and the responsibilities of firm leadership on an appropriate level. However, due to the level of details, we would suggest some clarifications of scalability options in this part.

South African Institute of Chartered Accountants

Generally, SMPs have greater constraints in terms of resources and are less able to absorb significant cost implications. To overcome this challenge, SMPs outsource requirements; specifically those relating to quality control, which raises concerns pertaining to their responsibility and accountability for their firms' quality control systems and whether the practitioners are taking ownership of their own quality.

The important role that governance and leadership play in establishing an effective SOQM that results in the objective of ED-ISQM 1 being met cannot be emphasised enough. SAICA welcomes the enhancements made in ED-ISQM 1, particularly as they relate to the expected behavior of firm leadership in setting the tone at the top, the appropriate qualifications of leadership, and holding leadership accountable through performance evaluations.

A pertinent concern raised in relation to the implementation of ED-ISQM 1 relates to the lack of resources. To this end, we welcome that ED-ISQM 1 now addresses firm leadership's ability to influence decisions about the firm's resources.

Wirtschaftspruferkammer

The proposed standard addresses firm's governance and the responsibilities of firm leadership basically at an appropriate, however rather prescriptive level. It is for example required:

The firm’s strategic decisions and actions, including financial and operational priorities, demonstrate a commitment to quality and to the firm’s role in serving the public interest, by consistently performing quality engagements (Para 23 (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 (Para 23 (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 (Para 23 (e)).

It remains unclear how and to what extent audit firms with limited personnel resources shall fulfil these requirements. We would like to give the IAASB a short overview on the structure in Germany:

As per December 31, 2017 in 42 per cent of all German audit firms only 1 professional accountant was engaged. 46 per cent of the German audit firms engaged 2 to 4 professional accountants. The vast majority (88 per cent) of the audit firms consists of only 4 or less professional accountants.

Regarding the audit firms which are registered as a statutory auditor and therefore are entitled to perform statutory audits the ratio is even more extreme: 95 per cent of these audit firms consist of only 10 or less professional accountants. For further details please refer to our Analysis of the market which is available under https://www.wpk.de/fileadmin/documents/Oeffentlichkeit/Wirtschaftspruefer/WPK_Marktstrukturanalyse_2017.pdf.

Against that background it remains debatable if the proposed requirements are sound to the majority of the professional audit firms. Several requirements can be achieved by informal measures and by the daily doing. Responses e.g. to factual failures by an individual of the organisation or the engagement team can be regularly sanctioned on an immediate basis. A formal response system might be over-engineered in these structures. In addition, we would like to point out that the flexibility would be limited, which is often crucial to the competitiveness of the mentioned practices.

By a purely formal approach, the requirements could be met; however this does not contribute to an enhancement of the quality. On the contrary: it would lead to a pure tick-box approach which is not in the public interest.

9. Individuals and Others

Shady Fouad Ahmed Mehelba

Yes, i support the process, and we believe adding some clarifications in regard responsibilities for managerial level personnel or partners whom will be responsible for the identification, assessment and evaluation or the change in profile of firm quality risk

Yes , we provide some suggestions for that in response question 8

Segregation of those responsible for the process of each component and those responsible for operational responsibilities will be enhances for sensitive engagement(listed entities and significant public interest ) may be important , evaluation of the process as one of the eight components may remain as a responsibility with governance and leadership and more considerations should be given to enhance governance by recommending more segregation responsibilities ,and accountability for risk assessment relate to those with expectation of pervasiveness risk .

development of one simplified governance terminology for that purpose of the ISQM and those who in charge in firms may be required , aligning with ISA 260 “communication with those charges with governance “description as in par. 10 and par. A1 to A8 . may enhance further development and reporting of ISQM1 in future
The partner or governance board should justify selection process of those who maintain responsibility for the quality management system in accordance to policies and procedures in less complex structure firm (things like non rotation, evaluation, qualifications would be of most important to compensate for less segregation) so that compensated responses may be a justification if in same relevancy to quality management objective

Training and Advisory Services and Chartered Accountants Academy

Yes

The revisions to the standard appropriately address firm governance and the responsibilities of firm leadership. ED – ISQM 1 addresses the expected behavior of firm leadership in setting the tone at the top, the appropriate qualifications of leadership, and holding leadership accountable through performance evaluations. However, the practicality of holding the sole management partner accountable through performance evaluations might be difficult or otherwise in some cases be a tick box exercise

Q7 - Disagree

3. National Auditing Standard Setters

Chinese Institute of Certified Public Accountants

The Governance and Leadership component is based on Control Environment in the COSO framework. However, we found that some elements of Control Environment are also applicable to the quality management system. But they are not covered by Governance and Leadership. In establishing quality objectives for Governance and Leadership, it is recommended that the following aspects be further improved. For example, there is no direct corresponding quality objective in terms of governance structure in ED-ISQM 1. For another example, performance evaluation and profit sharing arrangement is an important part of human resources policies. ED-ISQM 1 focuses only on the leadership who is responsible for quality management rather than all partners. As the third example, the quality objective of organizational structure is suggested to be explained. Because audit quality of different branch offices is uneven. The importance of branch office management is supposed to be highlighted.

Institut Der Wirtschaftsprufer

Quality Management should be integrated into the firm’s business processes rather of being managed in a separate compliance process and function

The draft as written leaves the impression that quality is managed through a separate process by one or more partners responsible for quality management with a focus on coordinating, monitoring and documenting a quality management system.

In contrast, in most larger firms, quality management is – under the leadership of the CEO or equivalent – the responsibility of those responsible for functional areas and who are in charge of the business processes relevant to achieving the quality objectives in their functional areas. For example, the individual responsible for the human resources functional area would be responsible for hiring appropriate people and for designing and implementing an effective learning program. Those responsible for business processes in their functional area would be required to identify the risks of not achieving their quality objectives and design and implement appropriate risk responses. For example, a quality risk in the human resources functional area could be that training needs are not appropriately identified, or that firm leadership is not...
providing the budgets necessary to implement the designed IPD or CPD program needed to obtain the appropriate competencies among firm personnel.

A quality management system organized and operated separately from the relevant business processes used to implement a firm’s strategy would not adequately focus on the drivers of quality because these are actually managed through the firm’s business processes.

Consequently, the standard should acknowledge that in larger firms, quality management would need to be integrated into the relevant business processes and those responsible for functional areas and the related business process need to be responsible for achieving the quality objectives relevant to their functional area.

We refer to section 4.1. in the body of our comment letter, which explains why we do not believe that the draft appropriately addresses governance and the responsibilities of firm leadership. Our response in the body of our comment letter also explains the changes needed.

4. Accounting Firms

Baker Tilly International

ED-ISQM1.23(a) – using the firm’s “Culture” makes this objective difficult to define and demonstrate. It may be more appropriate to say that “the firm’s leadership promotes a commitment...”. The leadership of the firm will directly impact its culture but is more easily identifiable.

We agree that governance and leadership are key to the achievement of engagement quality. However, we are concerned that this is an area where the revised standard is insufficiently scalable/tailored for smaller audit firms, i.e. SMPs and sole practitioners. The IAASB has acknowledged that feedback received identified that SMPs may experience practical challenges in implementing certain proposals and we are disappointed to learn that the IAASB has decided to ignore this feedback and retain these requirements for all firms. We believe that a “bottom up” or “building blocks” approach would present a more suitable, scalable set of requirements in this area.

It is important to distinguish between leadership and culture in these requirements. For example, ED-ISQM1.23a requires “the firm’s culture” to “…promote a commitment to quality”, whereas we believe it would be more appropriate to require leadership to promote such a commitment to quality which then, effectively, permeates into the firm’s culture.

We find ED-ISQM1.23e is trying to fit two objectives into a single requirement and that it would be more appropriate to either split them out or strip back to the requirement to a single objective. The present draft requires the firm to have resource plans to “support the commitment to quality” and also to “enable the design, implementation of the system of quality management”. We feel that simply requiring the resources to achieve the latter will, in effect, demonstrate resources which support the commitment to quality whilst simplifying the requirement.

We do not support the requirement set out in ED-ISQM1.25f. We do not think that is appropriate to have a core requirement in the standard which is only relevant in certain jurisdictions where law or regulation places firms under obligation to comply with a governance code or similar.

We believe that the requirements in ED-ISQM1.24(a)(iii) are not relevant for smaller audit practices, such as SMPs or sole practitioners, and therefore it will not be possible for such firms to meet the requirement to established structures, reporting lines etc. Furthermore, we are concerned that the requirement in ED-ISQM1.24b will be very difficult, if not impossible, to achieve in smaller practices as there will be nobody
able to perform such periodic evaluations of, for example, the managing partner in a single partner firm. Similarly, the requirement in ED-ISQM1.24c will also be very difficult to achieve in practice in a small firm (e.g. single partner). These are good examples of where we believe that the scalability of the standard would be enhanced by taking a “bottom up” approach of developing requirements that could apply to the smallest firms, with additional requirements for larger, more structured firms.

Finally, we note that para 48 of the explanatory memorandum attempts to clarify the requirements of ED-ISQM1.20 around understanding of the ISQM. We find it very difficult to reconcile an individual having responsibility for the system of quality management but NOT having an in depth understanding of the contents of ED-ISQM1. We believe that the amended wording is semantics only, and that to be truly responsible for quality management the individual assigned responsibility should have an understanding of the standard. Furthermore, ED-ISQM42c and ED-ISQM1.55 require the individual with ultimate responsibility to evaluate whether the system of quality management provides reasonable assurance that the objectives of the standard will be achieved; we cannot envisage how this evaluation can be effected without a detailed understanding of the standard. We do not support this change from extant ISQC1.

6. Member Bodies and Other Professional Organizations

Comision Interamericana de Control de Calidad de la AIC

They do not treat it adequately, we consider that medium, small firms and individual professionals without employees do not have clearly defined how they should approach the corporate governance and leadership component

Comite Control de Calidad del ICPARD

They do not treat it adequately, we consider that medium, small and individual professionals without employees, do not have clearly defined the way in which they should approach the component of corporate governance and leadership.

European Federation of Accountants and Auditors for SMEs

While ED-ISQM 1 does address firm’s governance and the responsibilities of firm leadership at an appropriate level, it appears to be based on larger firms and thus many SMPs, especially sole practitioners, will struggle to see its relevance and to apply it in practice.

8. Academics

UNSW Audit Research Network

Governance and Leadership

While we strongly support this component, we feel that insufficient attention has been given to the role of governance and leadership in providing a fulfilling environment for, and leveraging off the motivation and commitment of, the firm’s personnel.

Illustrating the importance of a fulfilling environment to the achievement of quality, research highlights that the self reported incidence of quality threatening behavior (e.g., inadequate team member supervision) is positively associated with the extent to which firms fail to meet expectations relating to professional aspects of auditing (autonomy, training, collegiality) (Herrbach 2001). Similarly, Herda, Cannon and Young (2019) find that helping auditors appreciate the importance of their work to the broader community is associated
with greater workplace mindfulness and a reduced likelihood of quality threatening behaviors (i.e., premature sign off).

While evidence on whether professional and firm commitment is associated with behaviors positively impacting quality is mixed (e.g., Malone and Roberts 1996; Herda and Martin 2016), to the extent that commitment impacts turnover intentions (e.g., Nouri and Parker 2013), a failure to foster professional and firm commitment may impact the firm's ability to retain qualified personnel and have a negative impact on quality.

With regard to motivation, research has found that intrinsic motivation is associated with, for example, improved auditor judgments and a greater willingness to raise audit issues, and that the firm can emphasize and leverage off an individual's intrinsic motivation so as to make the quality enhancing behaviors more likely (e.g., Kadous and Zhou 2019; Kadous, Proell, Rich and Zhou 2019).

Given the fundamental importance to quality of providing a personally fulfilling environment, as well as leveraging off the motivation and commitment of firm personnel, we feel that firms should be required to establish quality objectives that address these issues. We recommend that paragraph 23 be expanded, either by listing an additional objective or by expanding a current objective, to give sufficient attention to providing a fulfilling environment for, and leveraging off the motivation and commitment of, the firm's personnel.

**Q7 - Unclear**

1. **Monitoring Group**

   **International Organization of Securities Commissions (IOSCO)**

   Firms should be required to centrally monitor progress on engagements against milestones to ensure that audits are adequately planned and executed on a timely basis and address possible issues for quality audits with deadline pressures.

   ISA 220/ ISQM 1 should encourage firms to have a learning culture by sharing findings by EQRs and applying root cause analysis.

   The ability to learn from mistakes and errors made is an essential element of quality management. A learning/improvement-oriented environment has certain cultural requirements and behavioral aspects to it, which are not addressed in the current ED.

   Firms should be encouraged to consider appropriately qualified and experienced external persons on governing boards with a focus on audit quality.

   The firm’s commitment to quality through governance and leadership should not only be limited to the expected behavior of personnel within the firm but should be extended to all parties involved in the audit (such as external servicers etc).

2. **Regulators and Audit Oversight Authorities**

   **Canadian Public Accountability Board**

   Conflicting Roles - Supervision vs Monitoring
The exposure draft does not explicitly distinguish between supervisory review activities (intended to detect and correct) and monitoring activities (to investigate root causes and remediate). This could lead to ambiguity and potential for conflict across levels and locations that compromise the integrity of the system.

In our review of firm quality management practices, we noted situations where processes and controls varied from location to location resulting in an increased risk in the overall control framework. We encountered circumstances where firms described centralized processes and controls but could not demonstrate the consistency and effectiveness of those or similar processes at a regional or office level. This may have been due in part to the lack of distinction being drawn in assigning accountabilities for supervisory review and monitoring, and the resulting challenges in delineating between the effectiveness of individuals in their different roles.

Leadership, at various levels, are likely to have dual and potentially conflicting roles for both supervisory review and dealing with system deficiencies due to unanticipated risks and conditions. The IAASB could do more to distinguish between these two roles in describing how accountability for supervisory and monitoring responses should be assigned.

3. National Auditing Standard Setters

Royal Nederlandse Beroepsorganisatie van Accountants

Some attention is given to actions to be taken to establish the expected behavior, but this is difficult to establish as this relates to ‘soft controls’. As mentioned earlier (see Q1a) more attention should be paid to ‘soft controls’. Although ‘tone at the top’ is mentioned in paragraph A27, this should be explained more in detail. For example, it is important to have an open culture where learning from mistakes is essential.

6. Member Bodies and Other Professional Organizations

Belgian Institute of Registered Auditors IBR-IRE

Concerning the roles and responsibilities (par. A32), we are not convinced that those mentioned are well described/consistent and that the interdiction to cumulate functions is well established and clear enough in the standard.

Additional comments on governance and leadership

2. Regulators and Audit Oversight Authorities

Canadian Public Accountability Board

In CPAB’s approach to evaluating quality processes to assess audit quality, we outline our expectations for the audit firms we regulate. For example, leadership should be able to demonstrate that they have effective processes to:

- Dynamically manage their client portfolio to identify emerging risks within their client base.
- Objectively evaluate and approve client acceptance and continuance and identify and monitor higher risk engagements.
- Reliably forecast resources, prioritize and align them to engagement risk, and resolve projected shortfalls in a timely manner.
- Monitor resource usage against capacity constraints to identify excessive workloads.
- Realign resources in a timely manner to maintain audit quality as circumstances change.
• Monitor the progress of audits and encourage two-way communication in order to support the escalation of matters requiring their intervention.

**Committee of European Audit Oversight Authorities**

20. We suggest that care is required in engagement performance to ensure that culture and behaviour sufficiently support the achievement of quality objectives both within the audit firm and at team level. Audit firms have informed us that culture plays a crucial role in underpinning professional scepticism and therefore we think that it is important to also emphasize the importance of culture in the firms’ quality management system.

**Financial Reporting Council United Kingdom**

As currently written, the requirement encourages a process rather than an outcome. We suggest the following editorial:

23(e) The firm plans for its resource needs, including financial resources, obtains, allocates or assigns resources, including financial resources, in a manner that supports the firm’s commitment to quality and the

**Irish Auditing and Accounting Supervisory Authority**

We suggest that care is required in engagement performance to ensure that culture and behaviour sufficiently support the achievement of quality objectives both within the audit firm and at team level. Culture plays a crucial role in underpinning professional scepticism and therefore we think that it is important to also emphasise the importance of culture in the firms’ quality management system.

**3. National Auditing Standard Setters**

**Australian Auditing and Assurance Standards Board**

There are several application material paragraphs that are duplicate of content elsewhere, for example A36 is duplicative of A32; A178 is duplicative of A174.

**Japanese Institute of CPAs**

The third sentence of A12, A21, A31, A32, the last sentence of A34, A35, A36, A39, A41, A57, A94, A97, A116, A121, A122, A137, A154, the first sentence of A172, the last paragraph of A180, A187 (excluding the last paragraph), and A188

**New Zealand Auditing and Assurance Standards Board**

Less is more approach for application material

A26 – not application material to assist in how to establish an appropriate culture, rather is explaining why it is important. Could condense and combine A26-A28.

A31 – It is not clear how this helps explain the objective. Firms can arrange themselves in various ways, and the standard does not have to give them permission to do so?

A32 – how does this link to QM – it is stating the obvious that firms will have different leadership structures based on their size, etc. How does this help?
A33 – sounds like a debate around which component you classify things in which does not really matter. Rather need application material on what/how this looks like.

A34 – repeats 20(a). Not very helpful

A35 – sounds like telling the firms how to plan?

A36 – why repeating A32? – as above A32 is not very helpful and this just repeats it.

A38 – sentence “in addition to assigning responsibility for compliance with independence requirements and the monitoring and remediation process” is repeating the requirement – condense?

A39 – how does this help – surely the firms can add more anywhere?

A41 – why is the standard setting out the consequences of performance evaluation for the leadership of the firm.

A44 – first sentence superfluous – establishing policies or procedures for dealing with complaints supports the firm’s commitment to quality. This would not be a requirement if it did not do so. Does not help in any way, rather is a justification. Delete.

A44 – what about failure to meet expectations?

A45 – unclear why this cross reference is here?

4. Accounting Firms

Baker Tilly International

Response: Our thoughts on the quality objectives of each component are set out below:

Governance and Leadership

ED-ISQM1.23(a) – using the firm’s “Culture” makes this objective difficult to define and demonstrate. It may be more appropriate to say that “the firm’s leadership promotes a commitment…”. The leadership of the firm will directly impact its culture but is more easily identifiable.

ED-ISQM1.23(c) – the last sentence “by consistently performing quality engagements” seems superfluous. The objective that strategic decisions and actions demonstrate commitment to quality and the firm’s role in the public interest is sufficient without this additional dimension.

ED-ISQM1.23(e) – it seems incongruous to have a “required objective” which is only applicable when there are jurisdictional requirements. This objective should be removed and the firm’s commitment to complying with laws and regulations dealt with elsewhere, for example in the section “Applying and complying with relevant requirements”.

MGI Worldwide

In the application material, paragraph A41 indicates that a “firm may take corrective actions to address a negative performance evaluation that may affect the firm’s achievement of its quality objectives” (our emphasis). As the standard’s aim is to help firms improve engagement quality, we consider there should be a requirement to take corrective actions in such cases. The extent of those actions would be determined by the firm but indications of potential deficiencies in quality management should be robustly dealt with.
Nexia Smith & Williamson

By contrast, some of the examples given in ED-ISQM 1 appear to us to be so obvious as not to need stating:

Paragraph A38 is perfectly understandable without the example.

PriceWaterhouseCoopers

**Paragraph 23** - We suggest that the clauses in the lead-in paragraph be rearranged as follows for better clarity: “The firm shall establish the following quality objectives that address the aspects of the firm’s environment, including the firm’s culture, decision-making process, actions, organizational structure and leadership, that support the design, implementation and operation of the other components of the system of quality management, including the firm’s culture, decision-making process, actions, organizational structure and leadership:”

5. Public Sector Organizations

Office of the Auditor General New Zealand

The IAASB could usefully consider the order of the proposed standard in respect of the individual assigned ultimate responsibility and accountability, as paragraphs 20, 24 and 25 do not appear to be in order. Logically, paragraph 20 should be after paragraph 25 not before. Paragraph 20 discusses the individuals’ assigned ultimate responsibility and accountability, and the individuals assigned operational responsibility. However, the requirement to assign responsibility to such individuals does not appear until paragraphs 24 and 25 and do not appear to be in the logical order.

Office of the Auditor General of Alberta

Response: As noted above, the proposal provides a strong framework for a firm to establish processes and controls over engagement quality. Firms make both quality and business decisions. These assessments are often conflicting, such as having only designated professionals complete an audit (increase in quality) and cost (business decision). ED-ISQM 1 does not incorporate significant changes to how or if a firm incorporates quality as a primary objective. If the IAASB determines quality should have an increased priority, consequences of non-compliance with standards or applicable legislation should be more explicitly stated. For example, paragraph 51(a) should state, “Take appropriate action, including completion of omitted procedures, to comply with relevant professional standards and applicable legal and regulatory requirements; and.” This would require firms and their personnel to complete all applicable professional standards and applicable legal and regulatory requirements. When a firm or personnel do not comply, they would need to go back to complete any omitted standards or requirements. Such a standard would significantly increase the accountability of the firm and personnel.

6. Member Bodies and Other Professional Organizations

Australian Accounting Professional and Ethics Standards Board

Paragraph A21 repeats the requirements of Paragraph 55, the start of paragraph A37 repeats the requirements in paragraph 24(a)(iii) and several other instances of repetition. APESB recommends the IAASB review the application material to remove repetition of requirements to reduce the overall volume of the standard.
Paragraphs A40 to A43 provide very descriptive ways for firms to undertake performance evaluations required by paragraph 24(b). This (and other examples) does not represent true application material and could be extracted into a guide on how to apply ED-ISQM 1. APESB recommends the IAASB review the application material to remove non-application material to reduce the overall volume of the standard.

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Complaints and allegations: the requirement in ISQC 1 (para 59) concerning the need to establish policies and procedures requiring documentation of complaints and allegations and the responses thereto seems to have disappeared. It might be argued that this is part of 'monitoring and remediation', but we would support retaining an explicit reference. The risk of litigation must be a potential risk to all firms regardless of size.

Para A35 (verbose and could be said in one line, referring to the need for capacity in the resource budget to deal with the unexpected)