Proposed ISQM 1\textsuperscript{1}: Issues and Recommendations

Overview and Key Objectives of the IAASB Discussion

In September 2019, the IAASB discussed proposals to address key themes arising from respondents’ feedback to the Exposure Draft (ED) of ISQM 1 (ED-ISQM 1). The proposals focused on the structure of the standard, the firm’s risk assessment process and the approach in the standard regarding required quality objectives and responses.

Following these discussions, the ISQM 1 Task Force (TF) has continued to focus on the key themes previously discussed with the Board, and has also considered respondents’ views on other aspects of ED-ISQM 1, resulting in proposed changes to the following aspects of proposed ISQM 1 ( Agenda Item 7-A):

(a) The structure of the standard;
(b) The firm’s risk assessment process;
(c) Monitoring and remediation;
(d) Required quality objectives and responses (demonstrated in the governance and leadership component and engagement performance component); and
(e) Networks.

The ISQM 1 TF plans to present a full draft of proposed ISQM 1 to the Board in March 2020, with a goal of approving the standard in June 2020. In order to achieve this, it is critical that the ISQM 1 TF has clear direction from the IAASB on the following matters explored in this paper:

(a) The approach to quality risk considerations, including the nature of the quality risk considerations and how the application material demonstrates how quality risks considerations apply to the components.
(b) The approach to required quality objectives and responses, including the level of granularity of the quality objectives and responses and the location of the specified responses in the standard.
(c) The manner in which risk has been embedded in monitoring and remediation, and how the standard addresses inspection of engagements.
(d) The approach to firm leadership’s annual evaluation of the system of quality management (SOQM).
(e) The proposals to address concerns about the need for more robust actions at the network level.
(f) Whether, overall, the proposals address respondents’ concerns on scalability, tailoring, complexity, prescriptiveness and applicability to all firms.

\textsuperscript{1} Proposed International Standard on Quality Management (ISQM) 1 (Previously International Standard on Quality Control (ISQC) 1), \textit{Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements}
A. Introduction and Background

1. The proposals outlined in this issues paper have been developed in response to:
   (a) The feedback from the Board discussion in September 2019; and
   (b) Comments on the following questions in ED-ISQM 1 that were not previously presented to the Board:
      (i) Question 3: Application material.
      (ii) Question 7: Governance and leadership.
      (iii) Question 12 and related sub-questions: Monitoring and remediation.
      (iv) Question 13: Networks.
      (v) Other additional comments on certain areas of ED-ISQM 1 that were not related to a specific question.

   Appendix 2 of this paper provides an overview of the responses to the questions outlined above.

2. It is the intention of the ISQM 1 TF to present a full draft of proposed ISQM 1 to the IAASB in March 2020. As a result, the remaining questions in ED-ISQM 1 that were not presented to the Board in September 2019 or December 2019, will be presented in March 2020. A tracking list of the questions in ED-ISQM 1 and when they were, or are planned to be, presented to the IAASB is included in Appendix 3.

Overview of Previous Board Discussion in September 2019 (see Agenda Item 4 of the September 2019 meeting)

Questions in ED-ISQM 1 that were covered:
- Question 1 and related sub-questions: Quality management approach, benefits of ED-ISQM 1 and scalability.
- Question 2: Implementation challenges.
- Question 4: Components and structure of ED-ISQM 1.
- Question 6 and related sub-questions: The firm’s risk assessment process.

Matters addressed by the ISQM 1 TF’s proposals:
- The components and structure of proposed ISQM 1;
- How proposed ISQM 1 deals with quality objectives, quality risks and responses;
- How the standard deals with the firm’s risk assessment process; and
- The scope of firms and services covered by proposed ISQM 1.

Appendices to this Paper and Other Agenda Items Accompanying This Paper

3. The following appendices and agenda items accompany this paper:

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<th>Appendix 1</th>
<th>Overview of the ISQM 1 TF’s activities</th>
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<td>Appendix 2</td>
<td>Overview of the responses to the questions in ED-ISQM 1 addressed in this paper</td>
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Structure of the Board Discussion

4. The Board discussion will follow the following order:
   (a) The Chair of the ISQM 1 TF will provide a brief introduction to each proposal in Section B, followed by Board input on the questions in each Section. The questions will follow the sequence as set out in this paper and will be asked by grouping of questions.
   (b) The draft that will be referenced for purposes of the Board discussion will be the clean version of the draft extracts of proposed ISQM 1 (Agenda Item 7-A).

Update on Respondent Comment Letters

5. Since the September 2019 meeting, one additional comment letter was identified from the Committee of European Audit Oversight Bodies that had not been included in the analysis of comments in September 2019. This respondent’s comments have been considered by the ISQM 1 TF in the context of all proposals presented to the Board to date (including September 2019) and included in the analysis of comments supporting the proposals in this paper. The ISQM 1 TF determined that the respondent’s comments did not alter the proposals in September 2019, since many of the respondent’s views were similar to the views expressed by other respondents.

6. This brings the total number of letters received to one hundred (100):

<table>
<thead>
<tr>
<th>Monitoring Group</th>
<th>4</th>
<th>Global</th>
<th>25</th>
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<tbody>
<tr>
<td>Investors and Analysts</td>
<td>2</td>
<td>Asia Pacific</td>
<td>17</td>
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<tr>
<td>Regulators and Audit Oversight Authorities</td>
<td>6</td>
<td>Europe</td>
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<td>National Auditing Standard Setters</td>
<td>13</td>
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<tr>
<td>Accounting Firms</td>
<td>25</td>
<td>North America</td>
<td>16</td>
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<tr>
<td>Public Sector Organizations</td>
<td>10</td>
<td>South America</td>
<td>4</td>
</tr>
<tr>
<td>Member Bodies and Other Professional Organizations</td>
<td>36</td>
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<tr>
<td>Academics</td>
<td>1</td>
<td></td>
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<tr>
<td>Individuals and Others</td>
<td>3</td>
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B. ISQM 1 TF’s Proposals on Proposed ISQM 1

7. This section sets out the ISQM 1 TF’s proposals that have been developed to address feedback to ED-ISQM 1. Given the Board feedback in September 2019, in addition to responding to feedback on specific areas of the standard, the ISQM 1 TF has focused on the following key areas of concern:

(a) The scalability of the standard and firms appropriately tailoring the SOQM for their circumstances;

(b) The complexity and prescriptiveness of the requirements; and

(c) Developing a standard that can be applied in all circumstances, including when firms only perform related services engagements.

8. Section B.10 summarizes which proposals discussed in this paper contribute to addressing these key areas of concern.

B.1 Restructuring of Proposed ISQM 1 and Nature of the Components

9. At the September 2019 meeting, the IAASB largely supported the ISQM 1 TF’s proposal to restructure the standard to reduce complexity and assist in clarifying the nature of the components and how they interrelate. This restructuring has given rise to the following changes to proposed ISQM 1, as reflected in Agenda Item 7-A:

(a) The firm’s risk assessment component has been moved before the governance and leadership component.

(b) Essential application material has been added in the section “System of Quality Management” to explain the governance and leadership component (see paragraph 22 of Agenda Item 7-A). This is to address concerns that locating governance and leadership after the firm’s risk assessment process may reduce the prominence and importance of this aspect of the SOQM.

(c) The requirements dealing with the responsibilities of firm leadership have been relocated to the section “System of Quality Management” (see paragraphs 22A–22B of Agenda Item 7-A). This is to emphasize the importance of these responsibilities, and that they are a prerequisite in setting up a SOQM. (Note: the requirements to assign operational responsibility for compliance with independence requirements and the monitoring and remediation process to an individual have been relocated to other sections of the standard)

(d) The explanations about the components in the introduction of the standard have been removed, as these were originally included to explain the firm’s risk assessment process because it came after the governance and leadership component. This has helped to reduce the overall length of the introduction.

10. The following structural changes have also been proposed in Agenda Item 7-A, which have been further explained in the sections below:

(a) A new section has been proposed dealing with “specified responses.” All responses required by the standard will be relocated to this section (see paragraph 41A of Agenda Item 7-A).

(b) The “evaluation of the SOQM” has been moved to a discrete section towards the end of the standard (see paragraphs 65A–65D of Agenda Item 7-A).
Matter for IAASB Consideration

1. Does the IAASB support the restructuring of the standard, including:
   
   (a) Moving the firm’s risk assessment process before governance and leadership;
   
   (b) Including essential application material to highlight governance and leadership;
   
   (c) The location of the requirements dealing with the responsibilities of firm leadership; and
   
   (d) The new sections for “specified responses” and “the evaluation of the SOQM”?

B.2 The Firm’s Risk Assessment Process

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<th>Relevant Paragraphs in Agenda Item 7-A</th>
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<tr>
<td>Requirements</td>
<td>Application Material</td>
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<td>22C–22H</td>
<td>A24F–A35C</td>
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11. The summary of respondents’ views on question 6 of ED-ISQM1 regarding the firm’s risk assessment process was included in Agenda Item 4 of the September 2019 meeting. Appendix 5 includes the draft minutes of the IAASB’s September 2019 discussion. In general, the Board supported:

   (a) Adjusting the requirement addressing establishing quality objectives.

   (b) Simplifying the requirements dealing with the identification and assessment of quality risks.

   (c) Addressing the threshold for identifying quality risks through the definition of quality risks and related application material, and aligning the terms used in the threshold to ISA 315 (Revised 2019).²

As a result, the changes made to the firm’s risk assessment process component and the changes to the definition of “quality risks” (paragraphs 19(q) and A14A of Agenda Item 7-A) reflect the changes discussed with the IAASB in September 2019.

Quality Risk Considerations (QRCs)

12. In September 2019, the Board discussed a revised approach to how the quality objectives, quality risks and responses are addressed in the components. This included a proposal to introduce “quality risk considerations” in each of the components that would comprise certain aspects of the quality objectives and responses from ED-ISQM 1, repurposed into QRCs. As indicated in Appendix 5, the Board supported the approach for addressing quality objectives, quality risks and responses and indicated the need to be clear that the QRCs are based on the nature and circumstances of the firm.

13. The ISQM 1 TF further explored introducing QRCs in two components: governance and leadership and engagement performance. This exercise revealed two challenges:

² International Standards on Auditing (ISA) 315 (Revised 2019), Identifying and Assessing the Risks of Material Misstatement
(a) Repurposing certain aspects of the quality objectives and responses from ED-ISQM 1 into QRCs blurred the distinction between quality objectives, quality risks and responses.

(b) Building in the nature and circumstances of the firm and engagements it performs into the QRCs in each component would result in extensive repetition across the components.

14. The ISQM 1 TF determined that the appropriate approach to incorporating QRCs in the standard would be to develop QRCs that represent:

(a) The nature and circumstances of the firm and the nature and circumstances of the engagements performed by the firm, as this promotes tailoring the system of quality management; and

(b) Considerations relevant to most of the components, i.e., a common set of QRCs that can be applied to all components, as this enables less repetition across the components and a simplified and less prescriptive standard.

15. The ISQM 1 TF is of the view that common QRCs that focus on the nature and circumstances of the firm and engagements it performs addresses many comments from respondents to the ED, in particular:

(a) Concerns about scalability (upwards and downwards) through:
   
   (i) Making the nature and circumstances of the firm and engagements it performs more direct and explicit and an essential element of the risk identification and assessment process.
   
   (ii) Centrally locating the QRCs, rather than specifying QRCs for each component, which enables the firm to approach the risk identification and assessment process in a manner appropriate for the firm (e.g., more holistically for the firm as a whole, or component by component).

(b) Concerns regarding the robustness of the firms’ risk assessment process, because the factors to be considered by the firm are clearer. This may also address comments about the need for the requirements to be “inspectable” and concerns about firms’ judgments being challenged by external regulators.

(c) Concerns regarding the lack of clarity of the starting point in identifying quality risks and observations about the absence of quality risks in the standard, as well as comments regarding a lack of clarity of how the specified responses link to the quality objectives.

(d) Calls for implementation support regarding how a firm would go about identifying and assessing quality risks, because it is clearer what needs to be considered.

(e) Suggestions from Monitoring Group (MG) members that changes in the external environment and a firm’s own business model, and the results of external inspections should be taken into account as part of identifying and assessing quality risks, as these aspects have been built in to the proposed QRCs.

16. The ISQM 1 TF considered the appropriate level of granularity of the QRCs, and noted that QRCs that are too granular would likely:

(a) Result in QRCs that are not applicable to all components, or all firms.
(b) Drive the need for QRCs for each component, rather than common QRCs for all components.

(c) Increase the volume and prescriptiveness of the standard.

(d) Bring into question whether the QRCs are complete (i.e., similar to the reaction respondents had regarding the completeness of the specified responses).

17. Nevertheless, within the application material for the QRCs, the ISQM 1 TF has provided examples of more specific QRCs (see paragraphs A24N and A24O of Agenda Item 7-A). The ISQM 1 TF notes that these examples may need to be elaborated or refined as proposed ISQM 1 is progressed.

18. The ISQM 1 TF also developed examples to demonstrate how the QRCs are taken into account by the firm, and how they may give rise to quality risks and affect the responses designed and implemented by the firm (see paragraphs A24R, A35A, A112A and A159A of Agenda Item 7-A). It is the intention of the ISQM 1 TF to develop similar examples for each component. The ISQM 1 TF had mixed views regarding whether the examples should be located in the application material or a separate guide:

(a) Locating the examples in the application material in the standard would help illustrate the practical application of the requirements of the standard, highlight scalability, and may be used as a mechanism to address certain issues raised by respondents (e.g., addressing non-assurance services which has been raised by the Public Interest Oversight Board (PIOB)).

(b) Locating the examples in a separate guide would be more appropriate because the examples are incomplete and the illustrative responses may be interpreted as the appropriate response in all situations when the circumstances described arise. Instead, higher level examples should be included in application material in the standard.

19. Given these varying views, the ISQM 1 TF is seeking the Board’s input on the appropriate location of the examples in paragraphs A24R, A35A, A112A and A159A of Agenda Item 7-A.

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**Matters for IAASB Consideration**

2. Does the IAASB support introducing common QRCs and locating the QRCs in the firm’s risk assessment process?

3. Does the IAASB agree with the QRCs specified in paragraph 22E(b) of Agenda Item 7-A, and the related application material in paragraphs A24N and A24O of Agenda Item 7-A (i.e., are there additional QRCs, or do any QRCs need to be removed)?

4. With respect to the examples in paragraphs A24R, A35A, A112A and A159A of Agenda Item 7-A, does the IAASB support:

   (a) The granularity of the examples; and

   (b) Locating the examples in the application material in the standard, or in guidance separate from the standard?

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**Other Changes to the Firm’s Risk Assessment Process Component and Related Definitions**

20. The ISQM 1 TF considered all other comments from respondents to the ED, as well as input from the IAASB Consultative Advisory Group (CAG) in September 2019 and the PIOB’s list of public interest issues. The ISQM 1 TF has proposed the following changes to address these comments:
(a) New application material has been introduced explaining the information sources that would be used by the firm as part of the firm’s risk assessment process (see paragraph A24H of Agenda Item 7-A). Furthermore, a requirement that requires the firm to modify the quality objectives, quality risks and responses if deficiencies indicate that they are not appropriate was relocated from monitoring and remediation to the firm’s risk assessment process (see paragraphs 22H and A184A of Agenda Item 7-A). These changes are intended to improve the focus on the integrated nature of the components and explain how information from components feed into other components. Furthermore, these changes address comments that information may include information from within the firm’s enterprise risk management system.

(b) New application material has been introduced to clarify when additional quality objectives should be established, through introducing examples of additional quality objectives and including an explicit statement that additional quality objectives are not always required (see paragraphs A24I and A24J of Agenda Item 7-A).

(c) Essential application material has been added to emphasize that the responses specified in the standard will not be sufficient to achieve the objectives of the SOQM (see paragraph 22F(b) of Agenda Item 7-A).

(d) The requirement addressing modifications to the quality objectives, quality risks or responses has been enhanced to encourage firms to proactively identify when modifications are needed, through requiring the firm to establish policies or procedures to identify information that may indicate changes affecting the system (see paragraph 22G of Agenda Item 7-A). The ISQM 1 TF noted it would not be appropriate to prescribe how frequently a firm should re-evaluate its quality objectives, quality risks and responses because they should be modified when changes affecting the system occur, or when deficiencies are identified.

Definitions Related to the Firm’s Risk Assessment Process

21. The following changes have been made to the definitions related to the firm’s risk assessment process:

   (a) The definition of quality objectives was adjusted to align with other changes made to the standard, and to address comments that the definition was circular (see paragraph 19(p) of Agenda Item 7-A).

   (b) The definition of quality risks and related application material was adjusted to include the threshold for identifying quality risks, as discussed with the Board in September 2019 (see paragraph 19(q) and A14A of Agenda Item 7-A).

   (c) A new definition of “quality risk considerations” has been introduced (see paragraph 19(qA) of Agenda Item 7-A).

Matters for IAASB Consideration

5. Does the IAASB support the proposed changes to paragraphs 22G and 22H of Agenda Item 7-A to improve the proactivity of the firm in identifying information that may indicate changes in the factors affecting the SOQM?

6. Does the IAASB support the changes to the definitions related to the firm’s risk assessment process (paragraphs 19(p), 19(q) and 19(qA) of Agenda Item 7-A)?
B.3 The Approach to Quality Objectives and Responses in the Components

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<th>Relevant Paragraphs in Agenda Item 7-A</th>
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<tr>
<td>Requirements</td>
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<td>23, 36 and 41A</td>
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22. In September 2019 the Board discussed the nature of the firm's risk assessment process and monitoring and remediation (i.e., that these are processes), as well as a revised approach to how the quality objectives and responses are addressed in the components. Appendix 5 includes the draft minutes of the IAASB's September 2019 discussion. Since the Board supported the concept that the firm's risk assessment process and monitoring and remediation processes are “processes” in nature, the discussion below relates to the quality objectives and responses within the other six components in proposed ISQM 1.

23. As a result of the Board’s support for adjusting the quality objectives and refining the required responses, the ISQM 1 TF explored applying the approach to two components: governance and leadership and engagement performance. In particular, the ISQM 1 TF focused on:

(a) Grouping quality objectives to help streamline the quality objectives, where appropriate.

(b) Reducing duplication between quality objectives and responses.

(c) To the extent that a response directly related to a quality objective, combining the quality objective and response to streamline the requirements overall.

(d) Relocating more granular aspects of the requirements to application material to help address the perceived prescriptiveness of the requirements.

24. Through undertaking this exercise the ISQM 1 TF identified that very few responses remained in these two components. The ISQM 1 TF also noted that the responses that remained could relate to more than one component, for example, policies or procedures dealing with complaints and allegations may address quality risks in governance and leadership, engagement performance and resources. As a result, the ISQM 1 TF is of the view that all responses for all components should be relocated to a separate section of proposed ISQM 1 (see paragraph 41A of Agenda Item 7-A). This approach has many benefits including:

(a) Improving the integration of the components, since the responses may relate to multiple components.

(b) Clarifying that the specified responses alone are not sufficient to achieve the objective of the standard. This addresses concerns, particularly of MG members, that firms may be overly focused on the specified responses. It is also clearer that firms need to supplement and tailor their SOQM, including scaling up.

(c) Addressing concerns raised by respondents to the ED that the responses across the components are inconsistent (e.g., some components had many, others had none).

(d) Reducing the perceived prescriptiveness of the standard.
The ISQM 1 TF noted that this approach would also be similar to the “control activities” component described in ISA 315 (Revised 2019) and in the COSO Integrated Framework.\textsuperscript{3}

### Matters for IAASB Consideration

7. Does the IAASB support how the quality objectives and responses have been adjusted and refined in the governance and leadership component and engagement performance component (paragraphs 23 and 36 of Agenda Item 7-A)?

8. Does the IAASB support relocating responses for all components to a separate section of proposed ISQM 1, “Specified Responses” (paragraph 41A of Agenda Item 7-A)?

### B.4 Monitoring and Remediation Process

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<th>Relevant Paragraphs in Agenda Item 7-A</th>
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<tr>
<td>Requirements</td>
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<td>42–54</td>
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25. Question 12 of ED-ISQM 1 asked various questions on monitoring and remediation, and the feedback from respondents is summarized in Appendix 2. Based on the themes identified through the comments, the ISQM 1 TF has focused on addressing the following matters:

(a) How to incorporate a risk-based approach in monitoring and remediation;

(b) Improving the flexibility of the requirements for the performance of engagement inspections in a manner that is appropriately robust; and

(c) Clarifying the framework for evaluating findings and identifying deficiencies.

#### How to Incorporate a Risk-Based Approach in Monitoring and Remediation

26. As highlighted in Appendix 5, in September 2019 the Board expressed mixed views about the interrelationship between the firm’s risk assessment process and monitoring and remediation process, and whether the firm’s risk assessment process is applied to the monitoring and remediation component.

27. The ISQM 1 TF is of the view that the components of the SOQM are integrated and that a risk-based approach should be embedded throughout the standard to drive proactive management of quality. This includes establishing requirements that clearly set forth a risk-based approach to the monitoring and remediation component.

28. The ISQM 1 TF is of the view that the manner in which the monitoring and remediation component was presented in ED-ISQM 1 did not clearly articulate that it is a risk-based approach, and that efforts to link the firm’s risk assessment process to the monitoring and remediation process added unnecessary complexity to the standard. The ISQM 1 TF therefore proposes that this component be amended to better reflect a risk-based approach. Doing so would address multiple comments from respondents, including:

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\textsuperscript{3} Committee of Sponsoring Organizations of the Treadway Commission (COSO), \textit{Internal Control – Integrated Framework}
(a) Encouraging a proactive and preventative approach to monitoring, and the use of innovative monitoring activities.

(b) Improving the robustness and timeliness of monitoring, since activities would be focused on areas of risk.

(c) Concerns about the lack of scalability in this component.

(d) Encouraging a culture of improvement and learning.

29. The ISQM 1 TF explored various approaches that could be used to entrench a risk-based approach in monitoring and remediation. This included enhancing the approach proposed in ED-ISQM 1 (i.e., the firm’s risk assessment process is applied to the monitoring and remediation component) through introducing application material that explains how the QRCs apply to monitoring and remediation, as has been demonstrated in the governance and leadership and engagement performance components (see paragraphs A35A and A112A of Agenda Item 7-A). However, the ISQM 1 TF is of the view that retaining the concept that the firm must identify and assess quality risks for monitoring and remediation results in the standard being over-engineered and complex because, unlike the other components, the requirements in monitoring and remediation are comprehensive. In other words:

(a) The fundamental purpose of identifying and assessing quality risks is to provide the basis for designing and implementing responses.

(b) The requirements in monitoring and remediation already inherently incorporate all aspects that are required by a firm when designing and implementing monitoring and remediation, including monitoring activities, identifying and evaluating deficiencies, root cause analysis, remediation and communications.

(c) Given the fulsomeness of the requirements in monitoring and remediation already address the fundamental purpose of identifying and assessing quality risks, the need to identify and assess quality risks is not necessary to supporting the firm in designing and implementing responses.

30. Given that the requirements addressing the monitoring activities are comprehensive, and refer to various factors that focus the firm on areas of risk in determining the nature, timing and extent of monitoring activities (i.e., the factors in paragraph 44(a)–(e) of Agenda Item 7-A), the ISQM 1 TF is of the view that the best approach to embedding risk in monitoring is to directly state the quality risk for monitoring activities. This has been done in paragraph 44 of Agenda Item 7-A, through stating that the monitoring activities are designed and performed “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.” This addition to the requirement also sets the background for the extent of monitoring activities that need to be performed.

31. The ISQM 1 TF views the manner in which the quality risk has been described as similar to the concept of detection risk in an audit of financial statements. However, while the manner in which the requirement has been established focuses on the detection of deficiencies, monitoring activities may also prevent deficiencies from arising. As a result, application material has been added to explain how monitoring activities may serve to prevent deficiencies, which also addresses comments from respondents regarding the need to emphasize a preventative approach in the standard.

32. The ISQM 1 TF also considered how to address risk in the context of investigating the root cause(s) of deficiencies and remediation activities. The ISQM 1 TF noted that risk is already incorporated into
the requirements of ISQM 1 through the consideration of the severity and pervasiveness of the identified deficiencies, i.e., the nature and severity of deficiencies drives the nature, timing and extent of the root cause procedures, and also how the firm responds to the deficiencies (e.g., more severe deficiencies would drive a more urgent response). This approach enables the firm to modulate the remediation activities to address those deficiencies whose severity is the most significant and reduces the risk of deficiencies from reoccurring.

**Matters for IAASB Consideration**

9. Does the IAASB support the ISQM 1 TF’s proposed approach to embedding risk in the monitoring activities through directly stating the quality risk for monitoring activities?

10. Does the IAASB agree with the quality risk for monitoring activities, i.e., 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?

11. Does the IAASB support how the concept of risk has been embedded in the root cause analysis and remediation activities, i.e., through focusing on the severity and pervasiveness of identified deficiencies?

**Improving the Flexibility of the Requirements for the Performance of Engagement Inspections in a Manner That is Appropriately Robust**

33. The ISQM 1 TF noted the overall support from respondents for retaining a requirement addressing the performance of engagement inspections but noted that several respondents commented that:
   (a) The requirement is prescriptive and contrary to a risk-based approach.
   (b) The requirement discourages or creates a barrier to firms using other forms of innovative monitoring, including in-process reviews.
   (c) If the requirement is retained, it should be more focused on risk than a cyclical period.

34. In view of these comments, the ISQM 1 TF is concerned that the requirement in paragraph 45 of ED-ISQM 1 could:
   (a) Create the perception that, to achieve the objectives of the monitoring and remediation, it may be adequate for a firm to only perform inspections of completed engagements every three years (or less). The ISQM 1 TF is of the view that it would only be in rare circumstances that engagement inspections alone would be sufficient and appropriate monitoring activities (i.e., the firm needs a collection of monitoring activities tailored to the nature and circumstances of the firm and its engagements).
   (b) Inhibit firms from designing and implementing monitoring activities that are more proactive, preventative, effective and timely. The ISQM 1 TF is aware that some firms perform other types of monitoring activities that are more proactive, timely and effective in identifying and remediating deficiencies in the system of quality control, and that rigorous requirements to inspect engagements may create challenges for firms in using alternative forms of monitoring.

35. The ISQM 1 TF understands the need to preserve the requirement for a firm to perform inspections of completed engagements. While the inspection of in-process engagements is beneficial and may affect the extent of selection of completed engagements for inspection, it is optional for firms and the
ISQM 1 TF therefore believes it should not be referenced in the requirements. Instead, the inspection of in-process engagements has been highlighted in the application material supporting paragraph 44 of Agenda Item 7-A (see paragraph A157 of Agenda Item 7-A). With this amendment, the requirement in paragraph 45 of Agenda Item 7-A is only focused on the inspection of completed engagements.

36. The ISQM 1 TF is of the view that the appropriate manner for selecting completed engagements for inspection under a risk-based approach is to determine the appropriate combination of:

   (a) Which engagements need to be selected for inspection and how often, based on the risks associated with such engagements. For example, the firm may determine that audits of financial statements of listed entities or engagements performed in certain industries need to be subject to inspection on a cyclical basis.

   (b) Which engagement partners need to be subject to inspection, based on factors such as how long it has been since the engagement partner was subject to inspection, the results of previous inspections of the engagement partner, or the experience of the engagement partner.

37. Furthermore, the selection of completed engagements for inspection would also be affected by the nature, timing and extent of other monitoring activities undertaken by the firm. For example, if the firm has undertaken inspections of in-process engagements:

   (a) The firm may reduce the extent of selection of completed engagements for inspection; or

   (b) The results of the inspections of in-process engagements may indicate areas of risk that may affect the selection of completed engagements for inspection.

38. Paragraph 45 of Agenda Item 7-A has been adjusted to reflect a focus on engagement risk, the appropriate combination of selecting engagements and engagement partners, and taking into account how other monitoring activities may affect the selection of engagements. The ISQM 1 TF is of the view that these revisions address respondents’ concerns regarding the prescriptiveness of the requirements, lack of a risk-based approach and lack of flexibility to undertake other types of monitoring activities.

39. The ISQM 1 TF debated whether further revisions could be made to improve the flexibility of how the standard deals with the inspection of completed engagements, for example, by referring to another appropriate basis for selecting engagement partners instead of a cyclical basis. The ISQM 1 TF is of the view that referring to another appropriate basis could create further complexities in the standard. As a result, the ISQM 1 TF has retained the reference to a cyclical basis in the requirement, and adjusted the application material to improve the flexibility by removing the reference to three years.

Outreach with Firms

40. The ISQM 1 TF has initiated outreach with the largest six global networks to better understand:

   (a) What other types of monitoring activities other than inspection of engagements firms perform.

   (b) The benefits of other types of monitoring activities.

   (c) The mechanisms that firms use to obtain information about the quality of work performed by the engagement partner, other than through the results of inspection of engagements, in undertaking performance evaluations.
41. The ISQM 1 TF is of the view that this information may assist in determining whether the revisions outlined above will address concerns that the standard discourages using other forms of innovative monitoring or may generate suggestions for enhancing the standard. The ISQM 1 TF plans to obtain this feedback before the December 2019 meeting, and an overview of the feedback will be provided to the Board in the plenary session. This feedback may also be useful in developing guidance about different types of monitoring techniques, as suggested by respondents.

42. Although this outreach has been initially focused on the largest firms, the ISQM 1 TF plans to undertake outreach with other firms, regulators and stakeholders in the first quarter of 2020.

Other Changes to the Requirement Addressing Inspection of Engagements

43. Given feedback from respondents, revisions have been made to clarify the purpose of engagement inspections (see paragraph A170 of Agenda Item 7-A).

Matters for IAASB Consideration

12. Does the IAASB support the revisions to paragraph 45 of Agenda Item 7-A, that focuses on the effect of other monitoring activities on the selection of engagements for inspection, the appropriate combination of selecting engagements and engagement partners and the quality risks arising from the nature and circumstances of the firm’s engagements?

13. Does the IAASB support adjusting the application material to improve the flexibility of the standard, through removing the reference to three years in the context of the selection of engagement partners on a cyclical basis?

Clarifying the Framework for Evaluating Findings and Identifying Deficiencies

44. The ISQM 1 TF noted respondents’ concerns about the lack of a clear framework for evaluating findings and identifying deficiencies. The ISQM 1 TF determined that the following actions would assist in improving the clarity of the standard:

(a) Introducing a new definition of findings that more clearly distinguishes the difference between a finding and a deficiency and explaining that the firm identifies deficiencies through evaluating findings (see paragraphs 19(gA) and A9A of Agenda Item 7-A).

(b) Differentiating between engagement findings and findings related to the SOQM (see paragraphs 51, A11A and A172 of Agenda Item 7-A), and emphasizing that not all findings, including engagement findings are deficiencies (see paragraph A172B of Agenda Item 7-A).

(c) Reducing the complexity of the definition of deficiencies and providing examples of deficiencies in the application material to demonstrate how deficiencies may arise in all areas of the SOQM (see paragraphs 19(a) and A10 of Agenda Item 7-A). This action also addresses other comments from respondents, including a MG member, that the definition of deficiencies was over-engineered and had root causes embedded in the definition.

(d) Emphasizing that determining whether findings are deficiencies is a matter of professional judgment in the circumstances and depends on many quantitative and qualitative factors (see paragraph A172A of Agenda Item 7-A).
(e) Explicitly acknowledging the iterative nature of evaluating findings and identifying deficiencies and investigating the root cause(s) of identified deficiencies, as suggested by respondents (see paragraphs A172A and A175A of Agenda Item 7-A).

45. The ISQM 1 TF debated respondents’ suggestions that a concept such as “significant deficiencies” should be introduced. However, the ISQM 1 TF agreed that introducing a higher category of deficiencies would likely add more complexity to the standard. Instead, the ISQM 1 TF is of the view that firms should focus on the relative severity and pervasiveness of deficiencies, and how this information drives further actions, including investigating the root cause(s) of deficiencies, responding to deficiencies and the impact of deficiencies on the evaluation of the SOQM.

Other Matters Related to Monitoring and Remediation – Investigating the Root Cause(s) of Identified Deficiencies

46. The ISQM 1 TF noted the strong support for the new requirements addressing the investigation of the root causes of the identified deficiencies. Although respondents in general supported how the standard addresses positive findings, the following enhancements have been proposed:

(a) New application material has been added that encourages firms to contrast circumstances that have given rise to deficiencies with other similar circumstances (see paragraph A181 of Agenda Item 7-A), to encourage a culture of improvement and learning. The ISQM 1 TF did not consider it appropriate to refer to “good practice” or “positive findings” in the requirement, since these terms would need to be explained, and may be perceived as defining quality.

(b) Changing the terminology to refer to “other observations” and “positive outcomes” in place of “positive findings,” as recommended by some respondents (see paragraph A173 of Agenda Item 7-A).

47. Other amendments proposed by the ISQM 1 TF in response to respondents’ comments include:

(a) Additional clarification that not all findings need to be subject to a root cause analysis (see paragraph A172B of Agenda Item 7-A).

(b) Emphasizing that evaluating findings and identifying deficiencies, evaluating the severity and pervasiveness of a deficiency and investigating the root cause(s) of a deficiency are iterative (see paragraph A175A of Agenda Item 7-A).

Matters for IAASB Consideration

14. Does the IAASB support the definitions of “deficiency” and “finding,” and is the difference between a “finding” and a “deficiency” clear (see paragraphs 19(a) and 19(gA) of Agenda Item 7-A)?

15. How could the requirements for evaluating findings and identifying deficiencies be made clearer?

B.5 Evaluating the SOQM

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<td>Requirements</td>
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<td>65A–65D</td>
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48. Question 12(e) of ED-ISQM 1 asked a question on challenges that may arise in fulfilling the requirement to evaluate the SOQM and the feedback from respondents is summarized in Appendix 2.

The Purpose of the Evaluation of the SOQM

49. The ISQM 1 TF is of the view that placing the onus on firm leadership to evaluate the SOQM reinforces their responsibility and accountability for the SOQM and their responsibility to take further action in response to the outcome of the evaluation. In order to further emphasize this responsibility, and that leadership is responsible for the SOQM as a whole, the ISQM 1 TF has proposed:

(a) Separating the requirements dealing with the evaluation of the SOQM from the monitoring and remediation component and relocating the requirements in a standalone section towards the end of the standard; and

(b) Relocating the requirement addressing the performance evaluations of leadership to this section, because doing so reinforces that the outcome of the evaluation of the SOQM may reflect how leadership has performed (see paragraph 65D of Agenda Item 7-A).

50. Reinforcing the responsibility of firm leadership for the system is also how the ISQM 1 TF proposes dealing with the following comments raised by respondents, which highlighted a lack of clarity of the intended purpose of the evaluation:

(a) Respondents indicated that the requirement is, in effect, a self-assessment, in particular for Small and Medium Practitioners (SMPs). The ISQM 1 TF agrees with this observation, however notes that the fundamental purpose of the requirement is to focus leadership on their responsibility and accountability for the system and to take further action in response to the outcome of the evaluation; the evaluation is not intended as “independent assurance” that the system is effective. The ISQM 1 TF has also proposed clarifying what is intended by “reasonable assurance,” which includes an explicit statement that it is not an independent or external form of assurance (see paragraph A210A of Agenda Item 7-A).

(b) Respondents suggested the evaluation should be undertaken on a cyclical basis for certain firms, particularly SMPs. The ISQM 1 TF is of the view that a cyclical evaluation would not achieve the intended purpose of the requirement, i.e., that leadership is aware and conscious of the effectiveness of their SOQM. The ISQM 1 TF notes that the manner in which leadership of an SMP may evaluate the SOQM is likely to be less complex, and this has been emphasized in the application material (see paragraph A210B of Agenda Item 7-A).

Undertaking the Evaluation of the SOQM

51. The ISQM 1 TF debated various comments raised by respondents about whether the evaluation of the SOQM is performed at a point-in-time, whether it is an evaluation of the process or the outcome of the process, whether it is based on a “period ended” or an “as of date,” and how deficiencies that are in the process of being remediated are considered in the evaluation. The ISQM 1 TF noted that these factors would be affected by what reasonable assurance is sought on in the context of supporting the responsibility and accountability of firm leadership for the SOQM.

52. The ISQM 1 noted that, given some of the comments from respondents, there could be some views that the evaluation is intended to provide reasonable assurance that the system is designed.
implemented and operating effectively. The ISQM 1 TF is of the view that this approach is not appropriate since:

(a) It would be similar in concept to external assurance on the system, which as explained previously is not the intention of the requirement.

(b) It is inconsistent with the objective of the standard, which is focused on reasonable assurance that the objectives of the system have been achieved.

(c) The firm would likely need to determine that all deficiencies have been remediated which is not practicable because the SOQM is intended to be a process of continual improvement and the firm may have deficiencies that are in the process of being remediated. There may also be circumstances when the firm may not be able to remediate a deficiency until the next reoccurrence of the event that gave rise to the deficiency.

53. The ISQM 1 TF is of the view that the evaluation should focus on whether the system provides reasonable assurance that the objectives of the system are achieved. However, there may be varying perspectives of how this is determined:

(a) The evaluation determines whether the system provides reasonable assurance that the objectives of the system have been achieved over a period of time, i.e., a backward-looking evaluation of whether the system provided reasonable assurance that engagements performed and reports issued over this period were appropriate. A backward-looking evaluation would likely consider whether:

   (i) Identified deficiencies were remediated; or

   (ii) For identified deficiencies that are in the process of being remediated at the time of evaluation, whether the effect of the deficiency was appropriately dealt with (e.g., in the case of a deficiency that resulted in engagements not complying with professional standards, the engagements have been appropriately corrected).

This approach would likely be less proactive and preventative.

(b) The evaluation determines whether the system provides reasonable assurance that the objectives of the system will be achieved, i.e., a more current and forward-looking evaluation of whether the system provides reasonable assurance that engagements that are being performed, or that will be performed, and reports to be issued will be appropriate. A current or forward-looking evaluation would likely use information about how the system has performed over a period as the basis for determining whether it will provide reasonable assurance. This approach would likely focus on whether:

   (i) Identified deficiencies have been remediated; or

   (ii) For identified deficiencies that are in the process of being remediated, the firm’s plans to remediate the deficiencies are being developed in a proactive and timely manner.

54. The manner in which the requirement and related application material are developed in the standard is affected by what reasonable assurance is sought on in the context of evaluating the system. As a result, before making revisions to paragraphs 65A–65C of Agenda Item 7-A and the related application material, the ISQM 1 TF is seeking the Board’s input on what the evaluation should be focused on in the standard.
Performance Evaluations of Leadership

55. The ISQM 1 TF has proposed that the requirement dealing with the performance evaluations of leadership more prominently refer to the outcome of the evaluation of the SOQM. While this proposal reinforces leadership’s responsibility for the SOQM, it also:

(a) Addresses a suggestion from a MG member to elevate paragraph A40 of ED-ISQM 1 to a requirement.

(b) Partially addresses concerns raised that SMPs may find it challenging to undertake the performance evaluations, since it is now clearer that the evaluation of the SOQM is an information source for the performance evaluation.

Matters for IAASB Consideration

16. Does the IAASB support the intended purpose of the evaluation of the SOQM, i.e., that it reinforces the responsibility and accountability of firm leadership for the SOQM and their responsibility to take further action in response to the outcome of the evaluation?

17. The IAASB is asked to share their views what the evaluation of the SOQM should be focused on in the standard, i.e.:

(a) The evaluation determines whether the system provides reasonable assurance that the objectives of the system have been achieved over a period of time; or

(b) The evaluation determines whether the system provides reasonable assurance that the objectives of the system will be achieved?

B.6 Governance and Leadership

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<td><strong>Requirements</strong></td>
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<td>23</td>
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56. Question 7 of ED-ISQM 1 asked respondents whether the standard appropriately addresses firm governance and leadership, and the feedback from respondents is summarized in Appendix 2. Overall, there was general support for the proposals, however respondents variously commented further, either:

(a) Providing suggestions of additional matters to add to the requirements (see paragraph 22E(b)(i)d of Agenda Item 7-A); or

(b) Raising concern about the prescriptiveness and scalability of this component, particularly regarding the assignment of responsibilities.

57. Recognizing the need to deal with concerns about scalability, complexity and prescriptiveness, and at the same time retain the robustness of the standard, the revisions to the requirements in this component relate to:
(a) Refining the quality objectives and responses, as agreed by the IAASB in September 2019. In doing so, aspects of the responses have been included in the quality objectives in order to reduce the responses, and the quality objectives have been reorganized to be more streamlined. Furthermore, certain QRCs have replaced some of the quality objectives (e.g., the quality objective in paragraph 23(f) of ED-ISQM 1 dealing with law or regulation has been replaced by a QRC).

(b) Moving the requirements dealing with ultimate responsibility and operational responsibility for the SOQM to the section “System of Quality Management” (see section B.1 above).

(c) Moving the responses to the new section “Specified Responses” (see section B.3 above).

58. In moving the responses to other sections, the ISQM 1 TF determined that the following responses are better located in other sections of the standard:

(a) The requirement to assign operational responsibility for monitoring and remediation is better placed in the monitoring and remediation process component (see paragraph 43 of Agenda Item 7-A).

(b) The requirement to undertake performance evaluations of leadership is better located with the overall evaluation of the SOQM, since it would more strongly emphasize the responsibility of leadership for the system, and that the overall evaluation may be indicative of their own performance (see paragraph 65D of Agenda Item 7-A).

59. Other changes made to the application material to address comments from respondents to the ED and comments from the CAG at the September 2019 meeting include:

(a) An additional reference to “placing a focus on continual learning” (see paragraph A26 of Agenda Item 7-A).

(b) Examples where a firm may appoint an independent governing body (see paragraphs A24B and A35A of Agenda Item 7-A).

(c) An example that discusses a firm leadership team comprising representatives across the firm’s various business units, and the impact this may have on decisions affecting engagement quality (see paragraph A35A of Agenda Item 7-A). This is to address comments about how the culture of the firm’s audit and assurance service line may be affected by the culture of the firm as a whole.

(d) An explanation that addresses the integration of a quality culture and policies or procedures into the firm’s operational activities and processes (see paragraph A23A of Agenda Item 7-A). This is to address comments regarding the need for the SOQM to be integrated into the firm’s business processes.

60. The ISQM 1 TF is of the view that the above changes, in combination with introducing QRCs, have improved the robustness of the standard as it relates to governance and leadership.

Operational Responsibility for Relevant Ethical Requirements and/or Independence

61. Question 8 of ED-ISQM 1 also contained questions relevant to governance and leadership, as it sought respondents’ views about assigning operational responsibility for relevant ethical requirements and/or independence. The ISQM 1 TF considered the feedback on this question but
concluded that more discussion is needed with the Board about the QRCs and the approach to responses before developing proposals on this matter.

**Matter for IAASB Consideration**

18. Does the IAASB agree with the revised quality objectives for governance and leadership in paragraph 23 of *Agenda Item 7-A*?

**B.7 Engagement Performance**

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<th>Requirements</th>
<th>Application Material</th>
<th>Definitions</th>
<th>Other</th>
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<tbody>
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<td>36</td>
<td>A91–A112A</td>
<td>N/a</td>
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62. There were no questions in ED-ISQM 1 regarding engagement performance. However, where respondents commented on this component, the comments were collated and analyzed (see paragraphs 55 and 56 of *Appendix 2*).

63. The ISQM 1 TF considered all of these comments, however agreed that the revisions to this component should focus on refining the quality objectives and responses, including reducing repetitiveness between the quality objectives and responses, and moving aspects of the responses to the quality objectives in order to reduce the responses.

**Matters for IAASB Consideration**

19. Does the IAASB agree with the revised quality objectives for engagement performance in paragraph 36 of *Agenda Item 7-A*?

**B.8 Networks**

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<th>Requirements</th>
<th>Application Material</th>
<th>Definitions</th>
<th>Other</th>
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<tr>
<td>58–62</td>
<td>A192–A204</td>
<td>19(k), A13–A14</td>
<td>14</td>
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64. Question 13 of ED-ISQM 1 asked respondents whether they support the proposals addressing networks, and whether the proposals would address the issue of undue reliance by firms on networks. The feedback from respondents is summarized in *Appendix 2*. Overall, there was general support for the proposals, with various specific suggestions to enhance and clarify the proposals.

65. However, two MG members raised concern about how networks are addressed, noting the need for network-level quality management systems and processes to be within the scope of audit inspections and suggesting that the requirements in the standard be imposed at the network level. The PIOB has also urged the IAASB to address networks in the standard, and suggested focusing on consistent quality across the network, internal inspections and quality control monitoring.

**Further Discussions Regarding the Impact of ED-ISQM 1 on Networks**

66. The Explanatory Memorandum of ED-ISQM 1 explained why the IAASB had concluded it would not be appropriate to establish requirements for networks, and the ISQM 1 TF is of the view that these
considerations remain relevant. However, given that the concerns raised are considered a public interest issue by the PIOB, the ISQM 1 TF suggests further actions are needed to better understand how networks may be affected by proposed ISQM 1, and how to address the concerns of stakeholders.

67. The ISQM 1 TF notes that in developing ED-ISQM 1, the Board acknowledged that the requirements in the standard would likely have a profound impact on networks, albeit that they are imposed on the firm. The ISQM 1 TF is aware that:

(a) Many networks, particularly the largest six global networks, have already initiated activities to plan for the implementation of proposed ISQM 1.

(b) Many regulators have already engaged in discussions with the networks regarding their readiness activities for proposed ISQM 1.

68. The ISQM 1 TF is therefore of the view that further information is needed from networks regarding:

(a) The extent to which networks have already initiated implementation activities.

(b) How networks are planning on supporting network firms in implementing proposed ISQM 1.

(c) Based on the implementation activities already undertaken, the expected impact on the network and the relationship between the network and network firms.

The ISQM 1 TF has already initiated outreach activities with the largest six global networks to solicit feedback on these matters and is planning outreach in the first quarter of 2020 with other networks. The ISQM 1 TF also plans on undertaking outreach with regulators who have engaged in discussions with networks, to understand whether these regulators have concerns regarding networks, and the basis for their views.

69. The feedback from these outreach activities will be used as a basis for further discussions with stakeholders who sought more robust actions at the network level, to understand whether the impact on networks will address their concerns.

Consistent Quality Across the Network

70. The ISQM 1 TF understands that part of the concern of stakeholders regarding networks is the need for consistent quality across the network. Views were also expressed by respondents that the standard should emphasize how sharing common elements across a network can be instrumental in enhancing engagement quality.

71. The ISQM 1 TF agrees that consistent quality across a network is important and considered how the standard could be improved to address this issue. The ISQM 1 TF noted that proposed ISQM 1 is focused on the firm tailoring the SOQM to the circumstances of the firm, including in the context of network requirements and network services, which the firm is expected to adapt or supplement for their circumstances so that they are appropriate for the firm. As a result, if the standard focused on requiring consistency across the network, it could conflict with the notion that the firm’s SOQM should be tailored for the circumstances of the firm. The ISQM 1 TF is therefore of the view that instead the focus should be on whether the network requirements have been appropriately implemented across the network.

72. To encourage a focus on appropriate implementation across the network, the ISQM 1 TF has proposed a new requirement for the firm to obtain information from the network about how the
network determines that network requirements have been appropriately implemented across the network firms (see paragraph 61 of Agenda Item 7-A).

Other Changes to Proposed ISQM 1 Regarding Network Requirements and Network Services

73. The ISQM 1 TF considered comments from MG members and other respondents that the firm should be required to determine whether the network requirements and network services are appropriate for use. The ISQM 1 TF is of the view that:

(a) For network requirements:
   (i) The purpose and benefit of network requirements is that they are mandated by the network to promote consistency across the network.
   (ii) It would be rare that a network requirement is not appropriate, but common that the firm would need to supplement the network requirement because of circumstances unique to the firm.
   (iii) Requiring a firm to determine whether network requirements are appropriate could inadvertently imply that firms may choose to implement a network requirement differently, or not implement a network requirement, which would be contrary to the need to promote consistency across the network.

(b) For network services, as these are optional for the firm, the standard could be enhanced to require the firm to determine that these are appropriate.

74. In light of these views, the ISQM 1 TF has proposed various amendments to paragraphs 59, A197 and A198 of Agenda Item 7-A, which includes examples of how the network requirements or networks services may need to be adapted or supplemented.

75. Paragraph 59 of Agenda Item 7-A has also been amended to respond to comments seeking clarity on the work effort needed to support the evaluation of network requirements and network services. In particular:

(a) The amendments now refer to the understanding obtained in paragraph 58 of Agenda Item 7-A, as this is the information that would be used by the firm in evaluating the network requirements and network services.

(b) The reference to the firm’s risk assessment process has been removed, since it inadvertently focused the requirement away from the need to determine how the network requirements and network services affect the SOQM. The ISQM 1 TF is also of the view that the reference to the firm’s risk assessment process made the requirement more complex to understand.

76. Paragraph A201 of Agenda Item 7-A has been amended to clarify the extent or granularity of the information that the firm is expected to obtain from the network about the overall scope and results of the monitoring activities across the network firms’ SOQM, in order to respond to various comments from respondents seeking clarity about this communication.

Other Matters Relating to Networks

77. The ISQM 1 TF noted the implementation challenges highlighted by respondents, however the ISQM 1 TF is of the view that the requirements remain appropriate because there was overall support for the proposals.
78. The ISQM 1 TF recognized the comments from respondents regarding the need for harmonization or coordination with other jurisdictions, particularly in order to promote consistency across networks. The ISQM 1 TF values the contributions of the Public Company Accounting Oversight Board (PCAOB) Observers, who have actively participated in the TF discussions.

**Matters for IAASB Consideration**

20. Does the IAASB support the direction proposed by the ISQM 1 TF to address concerns regarding how networks are being addressed, i.e., undertaking further outreach and addressing the appropriate implementation of network requirements in paragraph 61 of Agenda Item 7-A?

21. Does the IAASB agree with the changes to paragraphs 59 of Agenda Item 7-A, as explained above?

**B.9 Other Proposals**

*System of Quality Management*

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79. The ISQM 1 TF noted that the manner in which paragraph 22 of ED-ISQM 1 was drafted was too compliance-focused. The ISQM 1 TF has revised paragraph 22 of Agenda Item 7-A to deemphasize the focus on compliance, given the concerns raised by respondents that larger firms should go beyond requirements of the standard. This change has also resulted in increased emphasis on the need for professional judgment.

80. Other revisions made to this section have been discussed under governance and leadership.

*Applying, and Complying with, Relevant Requirements*

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81. Revisions have been proposed to this requirement to address comments from respondents that firm leadership should be expected to have a full understanding of the standard. The ISQM 1 TF has also proposed new application material that explains that an individual assigned responsibility for a particular aspect of the SOQM may need to understand how their role contributes to the SOQM as a whole (i.e., that they may also need to have an understanding of proposed ISQM 1) (see paragraph A24E of Agenda Item 7-A).

*Drafting and Presentation (Including the Introduction and the Appendix)*

82. The ISQM 1 TF considered various options for drafting and presenting the requirements and application material in a manner that is easier to understand, and to reduce the overall length of the standard. Changes to the drafting and presentation of the standard include:

(a) Placing examples in the application material in separate boxes.
(b) Clearly signposting examples that demonstrate scalability (the term “scalability” has been used in the headings of these examples).

(c) Removing duplicative material, including removing:
   (i) Explanations in the introduction of the standard that were repetitive of the standard or overly detailed (see deleted paragraphs 5–6, 8–14 of Agenda Item 7-B);
   (ii) Application material that was repetitive of other material; and
   (iii) The appendix, given respondent’s observations that this is repetitive (this material will be repurposed in separate guidance).

(d) Removing application material that may only be relevant on first time implementation or material that, given its detailed nature, is more suited for inclusion in a separate guide (the comment boxes in Agenda Item 7-B indicate which material will be moved to a separate guide).

(e) Removing application material that was highlighted by respondents as unhelpful, unnecessary or superfluous (e.g., paragraph A21 and aspects of paragraph A49 and A59 of Agenda Item 7-B).

83. The ISQM 1 TF also compared the drafting and presentation to the approach in ISA 315 (Revised 2019).

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<th>Matters for IAASB Consideration</th>
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<tr>
<td>22. Does the IAASB support:</td>
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<tr>
<td>(a) The revisions made to the presentation of examples in the application material (i.e., the use of boxes and more clear identification of scalability examples);</td>
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<td>(b) Moving certain application material to implementation guidance, as indicated in the draft;</td>
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<td>(c) Reducing the explanations in the introduction; and</td>
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<td>(d) Removing the appendix?</td>
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**B.10 How the Proposals Address the Key Areas of Concern**

84. As highlighted previously in this paper, the ISQM 1 TF has focused on the following key areas of concern in addition to responding to feedback on specific areas of the standard:

(a) The scalability of the standard and firms appropriately tailoring the SOQM for their circumstances;

(b) The complexity and prescriptiveness of the requirements; and

(c) Developing a standard that can be applied in all circumstances, including when firms only perform related services engagements.

85. The ISQM 1 TF is of the view that the following proposals address these key areas of concern:
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<th>Scalability</th>
<th>Tailoring</th>
<th>Complexity</th>
<th>Prescriptiveness</th>
<th>Applicability</th>
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<tr>
<td>(a)</td>
<td>Restructuring the sequence of the components (firm’s risk assessment process moved before governance and leadership) and reducing the length of the introduction.</td>
<td>X</td>
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<td>(b)</td>
<td>Explicitly describing the firm’s risk assessment process and monitoring and remediation as processes.</td>
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<td>(c)</td>
<td>Adjusting the requirement to establish additional quality objectives to a “consideration,” including examples of when additional quality objectives may be required and explicitly stating that additional quality objectives are not always required.</td>
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<td>Simplifying the process for identifying and assessing quality risks and relocating the threshold for identifying quality risks to the definition of quality risks and application material.</td>
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<td>Introducing QRCs focused on the nature and circumstances of the firm and the nature and circumstances of the engagements performed by the firm that are common to all components and all firms.</td>
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<td>Explaining how the QRCs apply to each component in application material.</td>
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<td>Directly stating that the responses specified in the standard alone will not be sufficient to achieve the objectives of the SOQM.</td>
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<td>Refining the quality objectives and responses in the components, including moving detailed aspects of the requirements to application material.</td>
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### Matter for IAASB Consideration

23. Are there any further actions that need to be taken to address the key issues, i.e., scalability, tailoring, complexity, prescriptiveness and applicability of the standard?

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- **quality risks arising from the nature and circumstances of the firm's engagements.**
- **Clarifying the framework for evaluating findings and identifying deficiencies, including introducing a new definition of findings and reducing the complexity of the definition of deficiencies.**
- **Revising paragraph 22 of Agenda Item 7-A to deemphasize the focus on compliance.**
- **Removing the reference to the firm’s risk assessment process in paragraph 59 of Agenda Item 7-A.**
- **Signposting scalability examples in the application material, and presenting examples in the application material in boxes and tables.**
- **Within the examples in the application material, including examples that address small and large firms to demonstrate the “scaling-up” and the “scaling-down”.**
- **Moving some of the application material and the appendix to guidance outside of the standard.**
- **Removing duplicative material, or material that was viewed as unhelpful, unnecessary or superfluous.**
Appendix 1

ISQM 1 TF Activities Including Outreach and Coordination with Other IAASB Task Forces and Working Groups

1. The following sets out the activities of the ISQM 1 TF including outreach with others and coordination with other IAASB Task Forces and Working Groups relating to the quality management project.

Task Force Activities in Quarter 4 of 2019

2. In the 4th quarter of 2019, the ISQM 1 TF has met once in person and held five teleconferences.

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

ISA 220\(^4\) TF, ISQM 2\(^5\) TF and ISA 600\(^6\) TF

3. In the 4th quarter of 2019, the Chairs of the four Task Forces and staff held two teleconferences. Furthermore, Staff met via teleconference with the ISQM 2 TF to highlight key changes in proposed ISQM 1 and how these may impact the work of the ISQM 2 TF. Further coordination has also been facilitated through staff liaison.

International Ethics Standards Board for Accountants (IESBA)

4. Further coordination activities with IESBA are planned for the 1\(^{st}\) quarter of 2020.

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\(^4\) Proposed ISA 220 (Revised), Quality Management for an Audit of Financial Statements

\(^5\) ISQM 2, Engagement Quality Reviews

\(^6\) ISA 600, Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)
Appendix 2

Overview of Responses to the Questions in ED-ISQM 1 Addressed in this Paper

1. This appendix summarizes respondents’ views for the questions from the ED listed below. Respondents’ views on these questions have formed the basis for some of the proposals in the main body of this paper:
   (a) Question 3: Application material.
   (b) Question 7: Governance and leadership.
   (c) Question 12 and related sub-questions: Monitoring and remediation.
   (d) Question 13: Networks.
   (e) Other additional comments on the following areas of ED-ISQM 1 that were not related to a specific question.
      (i) The introduction;
      (ii) General requirements;
      (iii) The firm’s risk assessment process (additional comments not included in Agenda Item 4 of the September 2019 meeting as they did not relate to a specific question);
      (iv) Engagement performance; and
      (v) The appendix.

Approach to Analyzing Comments

2. NVivo was used to assist with the analysis of comments. The NVivo summaries reflect:
   (a) The number of respondents who “agreed”, “agreed but conditional or with further commentary”, or “disagreed” with the question. There were also responses where it was not clear whether the respondent agreed or disagreed, which have been classified as “unclear”. It is noted that respondents classified as “agreed but conditional or with further commentary” were those who appeared to agree but had additional concerns or suggestions. Respondents who “agreed” and provided further explanations of why they agreed were classified as “agreed”.
   (b) The general themes identified from further analyzing the comments for those respondents who “agreed but conditional or with further commentary”, “disagreed” or were “unclear”. In many cases, the additional concerns or suggestions raised by respondents who agreed were similar to the reasons provided by respondents who disagreed with the question, i.e., they had similar issues and concerns whether they agreed or disagreed. The general themes have therefore been numbered consistently across the three categories to reflect these similarities. The general themes are intended to provide an overview of key themes, and do not reflect the nuances of the individual comments. Furthermore, the general themes do not reflect one-off comments or suggestions, which have nevertheless been considered by the ISQM 1 TF.

3. The following points are also important for noting as part of the NVivo analysis:
   (a) In certain cases, respondents’ comments on a particular question were considered more relevant to another question or another aspect of ED-ISQM 1. Therefore, these comments were
re-assigned to the more relevant question or aspect, so that they can be considered in the context of all other relevant comments. Furthermore, some respondents provided general comments, which were also assigned to the most relevant questions or aspects. In some cases, a comment may have been assigned to multiple areas given the relevance to multiple issues.

(b) The general themes identified from further analyzing the comments only include respondents who had additional commentary. Furthermore, a respondent may have had multiple additional comments, which have been assigned to each relevant theme. As a result, the total number of respondents across all of the themes does not correlate to the total number of respondents who answered the question.

Application Material

| NVivo Summary of Analysis of Question 3 | Agenda item 7-C.1 |
| NVivo Report for Question 3             | Agenda Item 7-C.2 |

Overview of Responses to Question 3: Is the application material in ED-ISQM 1 helpful in supporting a consistent understanding of the requirements? Are there areas where additional examples or explanations would be helpful or where the application material could be reduced?

4. On the whole, respondents found the application material helpful. Additional recommendations included:

(a) Reducing the length of the application material, with suggestions to remove duplicative material, adopt the new drafting style of ISA 315 (Revised 2019) and relocate material outside of the standard, particularly material that supports implementation. In this regard, respondents indicated support for using other publications to provide additional support material.

(b) Developing more guidance or examples to demonstrate how the standard is scalable or operational for different firms (it is noted that some respondents indicated that this material be located outside of the standard).

(c) Repurposing some of the material from the explanatory memorandum into the standard or support materials, particularly the diagrams.

Respondents also cautiously noted that application material is sometimes interpreted as “de facto” requirements, or best practice.

5. Respondents who did not find the application material helpful were mostly of the view that the application material is too lengthy, and provided similar suggestions to those outlined above.
Governance and Leadership

Overview of Responses to Question 7: Do the revisions to the standard appropriately address firm governance and the responsibilities of firm leadership? If not, what further enhancements are needed?

Comments from MG Members

6. MG members commented positively on how the standard addresses governance and leadership, and provided various suggestions to further enhance the standard as follows:

   (a) In relation to the firm’s culture:

      (a) Encouraging firms to have a learning or improvement-orientated culture.

      (b) Extending the requirement addressing the commitment to quality to all parties involved in the audit (e.g., external service providers).

      (c) Providing guidance that addresses how the culture of the firm’s audit and assurance service line may be affected by the culture of the firm as a whole (i.e., in the case of multi-disciplinary firms who provide other types of services in addition to audits, assurance engagements and related services).

      (b) Introducing an additional quality objective addressing leadership oversight over other components, in particular information and communication and monitoring and remediation.

      (c) Encouraging firms to consider appointing appropriately qualified and experienced external persons to the firm’s governing body.

      (d) Elevating paragraph A40 of ED-ISQM 1 dealing with factors to consider when evaluating the performance of leadership to a requirement.

Comments from Other Respondents

7. Respondents across other stakeholder groups in general supported the proposals addressing governance and leadership, noting that governance and leadership is of paramount importance in a SOQM. Respondents also emphasized their support for increased focus on the responsibility and accountability of leadership and addressing the tone at the top.

8. However, there were respondents who did not consider that the standard appropriately addresses governance and leadership, largely because of their concerns about the scalability of this component. Concerns about the application of the requirements of this component to SMPs were also raised by respondents who agreed with the proposals, who suggested additional guidance to demonstrate how the proposals would apply to SMPs.

9. Respondents also commented on the level of prescriptiveness of the requirements, noting that:

   (a) It is not the role of the standards to prescribe audit firm governance; and

   (b) It should be at the discretion of the firm as to how responsibility for aspects of the system should be assigned, and who they should be assigned to, so that responsibilities are assigned to individuals with the appropriate authority in the circumstances of the firm.
10. Respondents also raised concerns on paragraph 24(b) of ED-ISQM 1 regarding performance evaluations of firm leadership, particularly as it applies to SMPs, noting that:
   
   (a) SMPs would likely find it challenging to find the appropriate person to perform the evaluation.
   
   (b) It will likely drive a compliance approach and SMPs would likely need external service providers to perform the review at an increased cost.
   
   (c) The requirement, together with the related application material, is confusing and creates diverging views on how this should be applied by SMPs.

11. Respondents provided various suggestions to further enhance the requirements in governance and leadership, including:

   (a) Encouraging firms to have a learning or improvement-orientated culture (also suggested by members of the MG).

   (b) Addressing the need for the SOQM to be integrated into the firm’s business processes (see also the summary of respondent comments on Question 1(a) of ED-ISQM 1 summarized in Agenda Item 4 of the September 2019 meeting). Respondents explained that various aspects of a SOQM are actually managed through the firm’s business processes, for example, the individual responsible for human resources would be responsible for hiring, learning etc. As a result, the individuals responsible for the business processes would need to be involved in quality risk identification and designing appropriate responses.

   (c) Clarifying what is intended by “appropriate experience and knowledge” regarding the individuals assigned ultimate responsibility for the SOQM. In particular, respondents questioned whether it would be appropriate for an individual who is not from the firm’s audit or assurance practice to fulfil this role.

12. Respondents also commented on paragraph 20 of ED-ISQM 1, dealing with leadership’s understanding of the standard, suggesting that firm leadership should be expected to have a full understanding of the standard.

Monitoring and Remediation

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<th>NVivo Summary of Analysis of Question 12 and related sub-questions</th>
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Overview of Responses to Questions 12 and 12(a): In your view, will the proposals for monitoring and remediation improve the robustness of firms’ monitoring and remediation? In particular:

(a) Will the proposals improve firms’ monitoring of the system of quality management as a whole and promote more proactive and effective monitoring activities, including encouraging the development of innovative monitoring techniques?

Comments from MG Members

13. A MG member noted their particular support for how ED-ISQM 1 has improved the clarity regarding the monitoring and remediation process. Another MG member noted the need for greater emphasis on preventative responses, for example, placing more emphasis on other actions that can be taken to proactively monitor responses. This respondent also indicated that firms should be explicitly required to demonstrate that their responses are present and functioning.
Comments from Other Respondents

14. Respondents agreed that the proposals in ED-ISQM 1 have the potential to improve the robustness of firms' monitoring and remediation and encourage more proactive and effective monitoring. It was variously noted that some firms have already taken action to implement more proactive monitoring techniques, and that formalizing it in the standard will encourage this approach to be adopted more widely. However, respondents were uncertain about whether or how the proposals would encourage firms to develop innovative monitoring techniques.

15. Respondents expressed mixed views about the flexibility of the requirements. On the one hand, there were respondents who thought that the requirements are appropriately flexible and will support firms in designing more tailored monitoring activities suitable to the circumstances of the firm. Conversely, other respondents indicated that this component is not sufficiently scalable and would be burdensome for smaller firms to implement. There were also respondents who thought this component was very lengthy and detailed.

16. Respondents also noted the significant changes proposed in this component, and therefore emphasized the need for an appropriate implementation period so that firms can redesign their monitoring and remediation processes.

17. Various further suggestions were made, including:
   (a) Addressing the need to test the operating effectiveness of responses (i.e., that they are present and functioning). It was noted that only focusing on whether the response has been performed is inadequate to provide a basis for determining whether the response is effective and achieves the quality objective.
   (b) Developing guidance on the monitoring and remediation process. There were respondents who emphasized the need for guidance to support firms in developing proactive and innovative monitoring techniques and suggested the use of examples.
   (c) Emphasizing that for SMPs, the issues identified through monitoring are likely to be more of a one-off nature and thus, the impact on quality from the monitoring activity will also be limited.

Overview of Responses to Questions 12(b): Do you agree with the IAASB’s conclusion to retain the requirement for the inspection of completed engagements for each engagement partner on a cyclical basis, with enhancements to improve the flexibility of the requirement and the focus on other types of reviews?

Comments from MG Members

18. MG members did not comment specifically on this aspect of the standard.

Comments from Other Respondents

19. Respondents in general supported the approach in ED-ISQM 1 dealing with engagement inspections, including the enhancements made from extant ISQC 1\(^7\) to improve the flexibility of the requirement and focus on other types of reviews.

\(^7\) ISQC 1, Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements
20. However, respondents further commented as follows:
   
   (a) The requirement and application material should be focused on risk, rather than a cyclical period. Respondents who did not support the approach to engagement inspections in ED-ISQM 1 also indicated that if the requirement is retained, it should be more risk-based.
   
   (b) The reference to a three-year cycle in the application material may have unintended consequences, as it may be interpreted as a de facto requirement and may not be an appropriate period for all firms. Respondents who did not support the approach to engagement inspections in ED-ISQM 1 also echoed this view.
   
   (c) The reference to in-process reviews in the requirement is confusing, since undertaking in-process reviews is not required. It was therefore suggested that it be moved to application material.
   
   (d) Clarity is needed about how the requirement to perform engagement inspections relates to the requirement to evaluation the SOQM annually, i.e., in order to provide a basis for evaluating the SOQM, whether the intention is that engagement inspections need to be undertaken annually.
   
   (e) How the requirement describes the purpose of engagement inspections needs clarification. Respondents provided various suggestions in this regard, such as referring to professional standards or referring to the components of the SOQM in general.

21. As highlighted in the preceding paragraph, respondents who did not support the approach to engagement inspections highlighted concerns about the focus on a cyclical period and reference to a three-year cycle in the application material. These respondents emphasized that the proposals are too prescriptive and contrary to a risk-based and proactive approach. They also highlighted that the proposals may reduce the ability of audit firms to dedicate resources to more innovative, timely and meaningful forms of monitoring that are more effective and efficient, including the use of technology-based initiatives.

Overview of Responses to Question 12(c): Is the framework for evaluating findings and identifying deficiencies clear and do you support the definition of deficiencies?

22. Respondents’ comments on this question were analyzed in two parts:
   
   (a) Whether the framework for evaluating findings and identifying deficiencies is clear (question 12(c) Part 1).
   
   (b) Whether respondents support the definition of deficiencies (question 12(c) Part 2).

Comments from MG Members

23. Only one MG member commented on the definition of deficiencies. This MG member raised concern that the definition is over-engineered and unnecessarily complex and noted that the criteria for undertaking root cause analysis are embedded in the definition. This respondent also indicated that it could lead firms failing to address defects in the SOQM and setting high-level objectives.
Comments from Other Respondents

Framework for Evaluating Findings and Identifying Deficiencies

24. Respondents expressed mixed views about whether the framework for evaluating findings and identifying deficiencies is clear. Respondents who found the framework to be clear indicated that it has the potential to deliver greater consistency in practice in identifying and evaluating deficiencies.

25. The majority of respondents who did not find the framework clear raised concern that there is no clear distinction between a “deficiency” and a “finding.” Furthermore, these respondents:

   (a) Noted that it is not clear how it is determined that negative findings are deficiencies, with some respondents indicating that it may be interpreted that all findings are deficiencies. Various suggestions were provided such as:

      (a) Including examples of findings and deficiencies.
      (b) Including factors or criteria that firms may consider when determining whether a finding is a deficiency.
      (c) Clarifying in paragraph A172 of ED-ISQM 1 that negative findings are those that give rise to indicators of potential non-compliance or of a deficiency in the SOQM.

   (b) Suggested introducing a definition of findings, for example, by moving the material in paragraph A172 of ED-ISQM 1 into the definition (this suggestion was also made by respondents who found the framework to be clear).

   (c) Highlighted inconsistent use of terminology (i.e., findings and deficiencies) in certain areas of the standard.

26. Respondents highlighted the iterative nature of identifying and evaluating deficiencies and undertaking a root cause analysis, i.e., that in determining whether negative findings are deficiencies, the firm may need to perform a root cause analysis. This observation led to further comments, including:

   (a) Concern that firms could overlook negative findings that are systemic and therefore likely to be a deficiency.
   (b) Suggestions that the firm’s policies or procedures should address when a root cause analysis is appropriate.

27. Suggestions were also made about the requirement to evaluate the severity and pervasiveness of the identified deficiencies, in particular:

   (a) Introducing concepts to address the varying severity of deficiencies, such as “significant deficiencies.”
   (b) Providing additional guidance to explain how the severity of deficiencies affects the annual evaluation of the SOQM.

28. There were also suggestions from respondents to develop additional guidance to support implementation in this area, and to use the diagrams in the explanatory memorandum in supporting material.
Definition of Deficiencies

29. Respondents expressed mixed views about the proposed definition of deficiencies. Respondents who supported the proposed definition suggested further clarifying the distinction between a deficiency arising from a quality risk, and a deficiency arising from a response to address an assessed quality risk. This suggestion was also noted by a respondent who disagreed with the definition, who noted that a quality risk that has not been appropriately identified or assessed is not a deficiency; rather it is a root-cause of a deficiency from a response that is not properly designed, implemented or operating effectively. Another respondent also suggested that the criteria for undertaking root cause analysis is embedded into the definition.

30. Respondents who disagreed with the definition of deficiencies indicated various concerns, such as inconsistencies with similar definitions used by national standard setters or regulators and a lack of a materiality concept embedded in the definition.

Overview of Responses to Question 12(d): Do you agree with the new requirement for the firm to investigate the root cause of deficiencies? In particular:

i. Is the nature, timing and extent of the procedures to investigate the root cause sufficiently flexible?

ii. Is the manner in which ED-ISQM 1 addresses positive findings, including addressing the root cause of positive findings, appropriate?

Comments from MG Members

31. MG members supported the new requirements for firms to establish policies or procedures addressing the investigation of the root causes of the identified deficiencies. One MG member further suggested that the standard should address consideration of good practice, in addition to investigating identified deficiencies, as this would contribute to a culture that is focused on improvement.

Comments from Other Respondents

New Requirement to Investigate Root Causes and the Nature, Timing and Extent of the Procedures to Investigate the Root Cause

32. Respondents strongly supported the new requirement addressing the investigation of the root causes of identified deficiencies and indicated that the nature, timing and extent of the procedures to investigate the root causes are sufficiently flexible. However, there was a strong call for guidance on how to perform the root cause analysis, with respondents highlighting that:

(a) Some firms have not previously performed root cause analysis and undertaking a root cause analysis may be a challenge for SMPs.

(b) There is a need for a consistent understanding globally, across national standard setters, regulators and others, of what is a root cause analysis.

33. Respondents also commented on the scope of the root cause analysis, variously suggesting that:

(a) The scope be more explicit that findings do not need to be subject to a root cause analysis; or

(b) The scope be adjusted to focus on investigating root causes of more severe deficiencies, such as significant deficiencies.
Respondents also emphasized the need to clarify the difference between findings and deficiencies (see paragraph 25), given that it affects which items are subject to the root cause analysis. Paragraph 26 also notes that respondents highlighted the iterative nature of identifying and evaluating deficiencies and undertaking a root cause analysis.

Positive Findings

34. Respondents overall supported how ED-ISQM 1 addresses positive findings, however certain respondents emphasized that firms would need to prioritize their efforts on remediating deficiencies, particularly in circumstances when resources are limited.

35. Respondents who supported how positive findings are addressed provided various additional suggestions, including:

(a) Further emphasizing the benefits of understanding positive findings;

(b) Including positive findings in the requirement in paragraph 47 of ED-ISQM 1; and

(c) Using other terminology to describe positive findings, such as positive outcomes, positive results or positive practices.

36. Respondents who did not support how ED-ISQM 1 addresses positive findings either indicated that the standard should:

(a) Go further in addressing positive findings, such as further emphasizing the benefits of understanding positive findings or addressing positive findings in the requirements; or

(b) Not address positive findings at all, as it goes beyond the requirements of the standard, and could lead to expectations that firms should address positive findings.

Overview of Responses to Question 12(e): Are there any challenges that may arise in fulfilling the requirement for the individual assigned ultimate responsibility and accountability for the system of quality management to evaluate at least annually whether the system of quality management provides reasonable assurance that the objectives of the system have been achieved?

Comments from MG Members

37. MG members did not specifically comment on this question or area of the standard.

Comments from Other Respondents

38. Respondents who did not think that the requirement would create challenges emphasized their support for the requirement, and that it reinforces the responsibility and accountability of leadership for the SOQM.

39. However, generally respondents noted that the requirement to perform an annual evaluation of the SOQM would present challenges, in particular the following:

(a) Performing the evaluation annually may be a large burden for certain firms and provides limited value, in particular for SMPs. It was therefore suggested that a longer period be established for certain firms, for example, every three years.

(b) The expectation that an individual assigned ultimate responsibility and accountability for the SOQM must understand the entire standard and undertake the annual evaluation is too
onerous. It may also be challenging to identify an appropriate qualified individual to assume this role.

(c) The requirement is, in effect, a self-assessment and there is a self-review threat. This is exacerbated in the case of smaller firms.

(d) Gathering the information necessary to support the evaluation may be challenging, and it may be difficult for the individual assigned ultimate responsibility and accountability for the SOQM to consider large volumes of information, particularly in larger firms.

(e) Documenting the firm’s processes to support the evaluation without being challenged by external inspectors may be difficult.

40. Respondents sought further clarity on:

(a) What is intended by the reference to “reasonable assurance” in the context of the SOQM. One respondent suggested adding the related explanation from the Explanatory Memorandum.

(b) How the severity of deficiencies affects the annual evaluation of the SOQM (also see paragraph 27(b)).

(c) Whether the annual evaluation is an ongoing evaluation or a point-in-time evaluation, whether it is an evaluation of the process or the outcome of the process, and whether it is based on a “period ended” or an “as of date.” These comments were closely linked to questions about how deficiencies that are in the process of being remediated are considered in the context of the annual evaluation.

(d) When the evaluation should be undertaken more frequently than annually.

Respondents also suggested developing additional guidance with examples to demonstrate how the requirement might work.

Other Comments on Monitoring and Remediation

41. Respondents provided additional comments on monitoring and remediation. In general, there were no clear themes, however it was noted that there were concerns about the ability of SMPs to fulfill the requirement in paragraph 46 of ED-ISQM 1, which addresses the individuals performing the monitoring activities.

Networks

| NVivo Summary of Analysis of Question 13 | Agenda item 7-C.1 |
| NVivo Report for Question 13 | Agenda Item 7-C.5 |

Overview of Responses to Question 13: Do you support the proposals addressing networks? Will the proposals appropriately address the issue of firms placing undue reliance on network requirements or network services?

Comments from MG Members

42. MG members supported the proposals addressing networks, however one member suggested that the standard is not sufficiently robust in addressing the firm’s responsibilities. In particular, this member noted that:
(a) The firm should be required to determine whether the network requirements and network services are appropriate for use, in the same manner that is required for service providers (this was also suggested by two regulators).

(b) The understanding of the network requirements and network services should not be performed by inquiry alone (this was also suggested by a regulator).

(c) It is unclear what work effort should be done to support the “evaluation” referred to in paragraph 59 of ED-ISQM 1.

43. Two other MG members emphasized the need for network-level quality management systems and processes to be within the scope of audit inspections. One of these members therefore urged the IAASB to give further consideration as to whether requirements can be imposed at the network level. They further commented that:

(a) All firms within a network should be expected to uniformly apply the auditing and ethical standards and that the network systems and processes should ensure that this is the case.

(b) Proposed ISQM 1 should clarify that any network requirements or network services are part of the firm’s SOQM and therefore are within the scope of any inspections of the firm.

Comments from Other Respondents

44. Respondents strongly supported the proposals addressing networks and considered that it would address the issue of firms placing undue reliance on network requirements or network services. Respondents particularly placed emphasis on the importance of the fact that the firm retains responsibility for the SOQM.

45. Various perspectives were shared about the impact the proposals would have on the network itself. Respondents noted that the proposals would likely:

(a) Drive more consistency across the network, for example, the approach to quality risk identification and assessment.

(b) Improve communication across the network.

(c) Facilitate an improved understanding of the network requirements and network services, and an improved understanding by the network of the firms’ SOQMs.

(d) Indirectly pressurize networks to remediate deficiencies in a timely manner.

46. There were concerns raised about the proposals, in particular:

(a) It may be challenging to consistently apply the proposals across the network. In this regard a respondent noted that not all network firms may be subject to proposed ISQM 1.

(b) It may be challenging for firms to obtain the information from the network, or other network firms.

(c) It could undermine the benefits of being part of a network.

These concerns were similar to those raised by respondents who disagreed with the proposals in ED-ISQM 1 (respondents who disagreed expressed concern over practical implementation challenges and highlighted the burden the proposals would place on firms).

47. Respondents provided various suggestions including:
(a) Improving the emphasis in the standard about how sharing common elements across a network can be instrumental in enhancing engagement quality.

(b) Clarifying the extent or granularity of the information that the firm is expected to obtain from the network about the overall scope and results of the monitoring activities across the network firms’ SOQM (see paragraph 61 of ED-ISQM 1).

48. Respondents also sought clarity or guidance on how the proposals should be implemented, particularly with respect to the work effort that is necessary to support the evaluation of the network requirements and network services.

49. Consistent with the views of certain MG members, a firm and a member body also suggested that networks need to be addressed, although one of the respondents suggested that proposed ISQM 1 is not the appropriate place to do so.

Harmonization with other Jurisdictions

50. Various respondents emphasized the need for harmonization or coordination with other jurisdictions. Respondents noted that diversity in professional standards makes it difficult for firms to develop and implement consistent systems and methodologies, creating challenges in implementing and operating an effective SOQM. Respondents therefore urged the IAASB to continue its coordination with other standard setters.

Other Additional Comments Not Specific to a Question

| NVivo Summary of Analysis of other additional comments | Agenda item 7-C.1 |
| NVivo Report for other additional comments | Agenda Item 7-C.6 |

The Introduction (Paragraphs 1–16 of ED-ISQM 1)

51. A MG member noted that paragraph A3 of ED-ISQM 1 is not clear how an acceptably low level is determined. This member suggested that the firm should consider its stakeholders when making this assessment, having regard to the public interest and the interests of the various stakeholders in the firm and, in particular, of audit, securities and financial services regulators. Another MG member also commented in general, in the context of the three quality management standards, on the need to clarify the relationships between the standards.

52. Respondents raised concern about the extent of introductory paragraphs. While some suggested that this material be relocated within the standard, others suggested locating it elsewhere as implementation guidance. On the other hand, there were suggestions to include the material from the Explanatory Memorandum in the introduction.

General Requirements (Paragraphs 20–22 of ED-ISQM 1)

53. Various suggestions were raised on the requirements and application material, but no clear themes were identified from these comments for further consideration.

The Firms’ Risk Assessment Process (Paragraphs 26–31 of ED-ISQM 1)

54. Agenda Item 4 of the September 2019 meeting summarized the feedback on the questions about the firm’s risk assessment process. The ISQM 1 TF identified additional comments that are related
to the firm’s risk assessment process but were not specific to the questions in the ED. In analyzing these comments, no clear themes were noted, other than concerns about the circularity of the definition of quality objectives.

*Engagement Performance (Paragraphs 36–37 of ED-ISQM 1)*

55. MG members variously commented on this component, including suggestions that:

(a) The standard require firms to perform pre-issuance technical reviews of banks’ financial statements.

(b) The exposure drafts clarify how quality management arrangements should operate where component auditors are used (this comment is being considered by the ISA 220 TF in conjunction with the ISA 600 TF).

(c) Firms 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.

Comments were also raised by other respondents about this component, but no clear themes emerged.

56. **Agenda Item 4** of the September 2019 meeting summarized the feedback related to how ED-ISQM 1 addresses professional skepticism. Additional comments were noted regarding how professional skepticism is addressed in the engagement performance component, but no clear themes were identified.

*The Appendix*

57. Respondents questioned the intended purpose of the appendix and noted that it duplicates material already in the main body of the standard. It was suggested that the appendix be located in a separate publication.
The following sets out a tracking list of the questions in ED-ISQM 1 and when they were, or are planned to be, presented to the IAASB.

<table>
<thead>
<tr>
<th>Question</th>
<th>IAASB discussion</th>
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<tbody>
<tr>
<td>Question 1 and related sub-questions</td>
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<td>December 2019</td>
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<td>Question 4</td>
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<td>Question 5 and related sub-questions</td>
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<td>Question 9</td>
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<td>Question 10</td>
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<td>Question 12 and related sub-questions</td>
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<td>Question 14</td>
<td>March 2020</td>
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<td>Additional Comments (Part 1)</td>
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<td>• Introduction</td>
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<td>• The firm’s risk assessment process (additional comments)</td>
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<td>• Engagement performance</td>
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<td>• Appendix</td>
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<tr>
<td>Additional Comments (Part 2)</td>
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<tr>
<td>• Definitions</td>
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<td>• Relevant ethical requirements</td>
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<td>• Acceptance and continuance</td>
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<td>• Documentation</td>
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<td>• Editorial comments</td>
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<tr>
<td>Support material</td>
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# List of Respondents to ED-ISQM 1

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<thead>
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<td>1 Basel Committee on Banking Supervision</td>
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<tr>
<td>2 International Association of Insurance Supervisors</td>
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<tr>
<td>3 International Forum of Independent Audit Regulators</td>
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<td>4 International Organization of Securities Commissions</td>
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<td>6 International Corporate Governance Network</td>
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<td><strong>Regulators and Audit Oversight Authorities</strong></td>
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<td>9 Financial Reporting Council United Kingdom</td>
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<td>10 Independent Regulatory Board for Auditors</td>
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<td>100 Vera Massarygina</td>
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Ms. French provided a summary of respondents’ feedback on the questions in the ED of ISQM 1 that related to the quality management approach, benefits to quality, scalability, the structure of ED-ISQM 1 and the firm’s risk assessment process. Ms. French explained the ISQM 1 TF’s proposals to address respondents’ views on these matters and provided feedback on the September 2019 IAASB CAG discussion.

The IAASB highlighted the need for the ISQM 1 TF to focus on the following four key areas of concern highlighted by respondents to ED-ISQM 1:

- Scalability;
- Prescriptiveness;
- The diversity of views regarding how to address firms who do not perform audit or assurance engagements and firms with very few partners; and
- Implementation challenges.

The IAASB further noted:

- The commonality of the issues arising on ED-ISQM 1 with other IAASB projects. The IAASB observed the need to address common issues through a collective approach across all projects and acknowledged that the audits of less complex entities (LCE) project is exploring how best to address concerns regarding scalability. Although the direction taken on the LCE project will be relevant to ISQM 1, the IAASB emphasized the need for the ISQM 1 project to continue to progress.
- The need to address respondents’ concerns in a manner that continues to achieve the objective of the project, i.e., encouraging proactive management of engagement quality so that firms’ systems of quality management are appropriate in their circumstances.

The IAASB encouraged the ISQM 1 TF to explore other ways of addressing the four key areas of concern highlighted above, in addition to the proposals outlined in Agenda Item 4, for example:

- Adjusting the drafting style of proposed ISQM 1 in a similar manner as ISA 315 (Revised 2019).
- Critically analyzing proposed ISQM 1 to identify material that is only relevant on first time implementation and placing such material in a separate implementation guide.

THE COMPONENTS AND STRUCTURE OF PROPOSED ISQM 1

The IAASB supported:

- The concept that the firm’s risk assessment process and monitoring and remediation processes are “processes” in nature. The IAASB further agreed that information and communication should be retained as a separate component.
- The proposals to reorder and restructure the standard to reduce complexity and to assist in clarifying the nature of the components and how they interrelate. The Board also suggested that in order to clarify how the components interrelate, the standard could explain how the components differ.
- Clarifying the nature of the components, including introducing new overarching requirements for the firm to establish a risk assessment process and monitoring and remediation process.
However, the IAASB:

- Expessed mixed views about the interrelationship between the firm’s risk assessment process and monitoring and remediation process, and whether the firm’s risk assessment process is applied to the monitoring and remediation component.
- Noted that within the components there are aspects that address "what needs to be managed" and "how it needs to be managed", and therefore encouraged the ISQM 1 TF to be cautious when addressing the different nature of components.

The IAASB also encouraged the ISQM 1 TF to clarify that quality management should be integrated into the strategy and operations of the firm and therefore the business processes.

**HOW QUALITY OBJECTIVES, QUALITY RISKS AND RESPONSES ARE DEALT WITH IN PROPOSED ISQM 1**

The IAASB supported the ISQM 1 TF’s proposed approach for addressing quality objectives, quality risks and responses, i.e., adjusting the quality objectives to be more high-level, introducing quality risk considerations, and refining the required responses. The IAASB:

- Emphasized the need to retain appropriate robustness in proposed ISQM 1, particularly in relation to requirements that exist in extant ISQC 1.
- Suggested there is a need to retain the specificity of some quality objectives and therefore not all quality objectives need to be raised to a higher level.
- Highlighted that quality risk considerations are considerations (i.e., not required quality risks), and represent the conditions and events that are relevant to the firm’s engagements that could cause quality not to be maintained. The IAASB also indicated the need to be clear that quality risk considerations are based on the nature and circumstances of the firm.
- Noted that as the requirements are developed, there is a need to ensure that they are appropriately enforceable and that documentation expectations are clear.

The IAASB suggested that the quality risk considerations could be used to address scalability concerns by dealing with quality risks associated with different types of engagements.

**THE FIRM’S RISK ASSESSMENT PROCESS**

The IAASB in general supported:

- The proposal to adjust the requirement in paragraph 26 of ED-ISQM 1, which addresses the establishment of additional quality objectives, to a “consideration” so that it is clearer that additional quality objectives are not required in all circumstances. The IAASB also suggested that if the quality objectives are comprehensive, an alternative approach could be to address how firms may describe the objectives in different ways.
- The ISQM 1 TF’s proposals to condense the risk identification and assessment process from a two-step process into a single step.
- Addressing the threshold for the identification of quality risks through the definition of “quality risks” and application material.
- Continuing to use the term “reasonable possibility” as a means to describe the threshold for identifying quality risks and removing the reference to “more than remote.” The IAASB also:
Encouraged the ISQM 1 TF to use thresholds and explain them in a manner that is consistent with ISA 315 (Revised 2019).

Suggested explaining how reasonable possibility is related to the concept of “acceptably low level,” consistent with ISA 315 (Revised 2019).

However, the IAASB emphasized the need to consider the effect of the above changes on the inspectability of the firm’s SOQM and expectations about what firms are required to document.

THE SCOPE OF FIRMS AND SERVICES COVERED BY PROPOSED ISQM 1

The IAASB did not support the proposal for developing separate requirements for firm-level quality management over related service engagements. In particular, the IAASB noted that:

- Proposed ISQM 1 needs to adopt a scalable, principles-based approach, such that it can be applied by firms of varying size and complexity, including those who perform only certain types of engagements. The IAASB suggested that implementation support material could be a mechanism that is used to address firms that only perform related services engagements.

- There is a need to understand the concerns about applying proposed ISQM 1 to related services engagements, and rather address the concerns directly in proposed ISQM 1.

- The LCE project needs to progress further before decisions are made about separate requirements for firm-level quality management over related service engagements.

The IAASB also did not support issuing a survey to obtain stakeholder input on the proposed way forward.

OTHER MATTERS

The IAASB emphasized the need for ongoing outreach with firms and regulators, given that firms have already commenced their implementation activities and regulators are questioning firms’ readiness.

IAASB CAG CHAIR’S REMARKS

Mr. Dalkin highlighted the IAASB CAG’s general concern about the length, complexity and prescriptiveness of proposed ISQM 1, and its application by SMPs. He emphasized the IAASB CAG’s support for a building block approach and including quality risk considerations.

PIOB OBSERVER REMARKS

Mr. Grund indicated that the objective of proposed ISQM 1 is compliance focused and needs to reflect the achievement of audit quality. Mr. Grund also noted the PIOB’s key public interest issues related to this project, i.e., networks, requiring firms to prepare transparency reports and appropriate coordination with IESBA.

WAY FORWARD

The ISQM 1 TF will consider the matters raised by the IAASB and will present further proposals on the key issues highlighted by the IAASB and other key aspects of proposed ISQM 1 to the IAASB in December 2019.