

Agenda Item 4–D (For Reference)

Staff Analysis: Tracking of Changes to Proposed ISQM 1¹ from the Exposure Draft of ISQM 1

ED ISQM 1	Proposed ISQM 1	IAASB Discussion (includes link to issues paper)	Section of Issues Paper Addressing Matter	Section of Issues Paper Summarizing Respondent Feedback	Overview of Key Revisions since ED-ISQM 1 (paragraph references are to Agenda Item B.3)
Introduction	Introduction	December 2019 (partial)		Appendix 2 - Other additional comments	<ul style="list-style-type: none"> Restructured paragraph 7 to bring more prominence to the description of the public interest. Revised paragraph 8A to clarify the objective of the standard and the objective of the system. Reduced descriptions to reduce overall length of the standard.
		March 2020	B.4	Appendix 2 – Question 5	
Effective Date	Effective Date	March 2020	B.16	See Agenda Item 5 of the September 2019 meeting	<ul style="list-style-type: none"> Clarified the intended meaning of the effective date (i.e., designed, implemented, and commence operation), given varying interpretations expressed in respondents' letters (see paragraph 17).
Objective	Objective	March 2020	B.4	Appendix 2 – Question 5	No proposed changes.
Definitions	Definitions	December 2019 (partial)	B.4	See also the feedback on monitoring and remediation	<ul style="list-style-type: none"> Reduced the complexity of the definition of deficiencies and provided examples of deficiencies in the application material to demonstrate how deficiencies may arise in all areas of the SOQM (see paragraph

¹ Proposed International Standard on Quality Management (ISQM) 1, *Quality Management for firms that perform Audits of Reviews of Financial Statements, or Other Assurance or Related Services Engagements*

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		March 2020	B.2	Appendix 2 - Other additional comments	<p>19(a) and A10). The intent is to provide clarity on the process for evaluating findings and identifying deficiencies.</p> <ul style="list-style-type: none"> Introduced a new definition of findings that more clearly distinguishes the difference between a finding and a deficiency (see paragraph 19(gA). The intent is to provide clarity on the process for evaluating findings and identifying deficiencies. Revised the definition of quality objectives to remove circularity and clarify what they are intended to be. Revised the definition of quality risks to include the threshold for identifying quality risks. Also revised the terminology describing the threshold to align with ISA 315 (Revised).² Clarified the scope of relevant ethical requirements through enhancing the application material explaining the applicability of Part 2 of the Code (see paragraph A16A).
Applying, and Complying with, Relevant Requirements	Applying, and Complying with, Relevant Requirements	December 2019	B.9	Appendix 2 - Other additional comments	<ul style="list-style-type: none"> Adjusted the requirement that firm leadership should have a full understanding of the standard, to address concerns raised by respondents.
System of Quality Management	System of Quality Management	December 2019	B.1, B.9	Appendix 2 - Other additional comments	<ul style="list-style-type: none"> Included new essential application material to emphasize the importance of governance and leadership, given that it is not the first component in the standard (see paragraph 22).

² International Standards on Auditing (ISA) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*

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		March 2020	B.5		<ul style="list-style-type: none"> • Reduced the focus on compliance to emphasize that larger firms should go beyond the requirements of the standard, and increased focus on professional judgment (see paragraph 22 and A24). • Requirements in governance and leadership dealing with assigning responsibility to firm leadership relocated to this section to emphasize the importance of these responsibilities, and that they are a prerequisite in setting up a SOQM (see paragraphs 22A-22B). • Adjusted the requirement dealing with the experience, knowledge and time of leadership to no longer be linked to the individuals assigned ultimate responsibility and accountability for the SOQM. This is to ensure that, irrespective of their knowledge, experience and time, ultimate responsibility and accountability for the SOQM should be assigned to the individual who is responsible for key decisions that would impact the SOQM, such as how resources are assigned in the firm. • Explained the integration of quality management into the firm's operational activities and processes to promote a harmonious approach to managing the firm and managing quality (see paragraph A21A). • Added application material to emphasize that the individuals assigned operational responsibility for the SOQM need to have an appropriate understanding of operational matters within the firm, so that the role is not perceived as a compliance function (see paragraph A24CA).

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					<ul style="list-style-type: none"> Explained 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).
The Firm's Risk Assessment Process <i>(Located after governance and leadership in ED-ISQM 1)</i>	The Firm's Risk Assessment Process (FRAP) <i>(Relocated since ED-ISQM 1)</i>	September 2019	C.1, C.2, C.3	B.4 (Question 6)	<ul style="list-style-type: none"> Relocated as the first component, given it is a different nature (i.e., a process) and to clarify how the process operates before reading the remainder of the standard. Introduced new requirement for the firm to establish a risk assessment process to clarify that it is a process in nature (see paragraph 22C). Adjusted the requirement to establish additional quality objectives to a "consideration" because it is not expected to be common that firms may need to have additional quality objectives (see paragraph 22D). Condensed the two-step process for risk identification and assessment into a single requirement to simplify the approach and minimize concerns about duplicative effort embedded within the two steps. Also refocused the requirement away from being process-driven, to outcome-based (see paragraph 22E). Introduced the concept of factors that may adversely affect the achievement of the firm's quality objectives and clarified the relationship between the factors and identifying and assessing the quality risks (see paragraph 22E). Factors are:
		December 2019	B.1, B.2	Appendix 2 - Other additional comments	
		March 2020	B.1		

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					<ul style="list-style-type: none"> ○ Focused on the nature and circumstances of the firm and the engagements performed by the firm; and ○ Relevant to most of the components. <p>The intent of the factors is to promote proactivity, scalability (upwards and downwards) and tailoring the SOQM to the firm’s circumstances. The intent is also to assist firms in “thinking through” what quality risks may arise and support a more robust risk identification and assessment process.</p> <ul style="list-style-type: none"> ● Added application material to explain how the factors relate to conditions, events, circumstances, actions or inactions (see paragraph A24N). ● Clarified the requirement addressing designing and implementing responses (see paragraph 22F). ● Revised the requirement addressing modifications to the quality objectives, quality risks or responses to further clarify the intent of the requirement and encourage firms to proactively identify when changes are needed (see paragraph 22G). ● Added new application material explaining the types of information sources that may be used by the firm in the firm’s risk assessment process to emphasize the continual flow of information across the SOQM (see paragraph A24H). ● Reduced the length of the application material by removing non-essential material and added examples to boxes to improve readability.

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Governance and Leadership	Governance and Leadership	September 2019	C.1, C.2		<ul style="list-style-type: none"> • Streamlined requirements (see explanation of streamlining in box below). • Adjusted quality objectives to be more outcome-based. • Relocated the following responses: <ul style="list-style-type: none"> ○ The response addressing the assignment of ultimate responsibility and operational responsibility for the SOQM was moved to the section “System of Quality Management” to emphasize the importance of these responsibilities, and that they are a prerequisite in setting up a SOQM. ○ The response addressing the assignment of operational responsibility for monitoring and remediation was moved to the monitoring and remediation component. ○ The response addressing the assignment of operational responsibility for independence was moved to “specified responses.” ○ The response addressing the performance evaluations of leadership was moved to the “evaluation of the SOQM” section, to reinforce that the outcome of the evaluation of the SOQM may reflect how leadership has performed. ○ The response addressing complaints and allegations was moved to “specified responses.” • Added application material explaining how the firm’s business model may influence incentive structures, and impact on quality (see paragraph A29).
		December 2019	B.3, B.6	Appendix 2 – Question 7	
		March 2020	B.6	Appendix 2 – Question 8	

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					<ul style="list-style-type: none"> Reduced the length of the application material by removing non-essential material and added examples to boxes to improve readability.
Relevant Ethical Requirements	Relevant Ethical Requirements	March 2020	B.7	Appendix 2 – Question 8 Appendix 2 - Other additional comments	<ul style="list-style-type: none"> Streamlined requirements (see explanation of streamlining in box below). Adjusted quality objectives to be more outcome-based. Clarified the scoping of relevant ethical requirements through adjusting the requirements to emphasize that the relevant ethical requirements are those to which the firm and the firm’s engagements are subject (see paragraphs 32(a)). Reduced the length of the application material by removing non-essential material and added examples to boxes to improve readability.
Acceptance and Continuance of Client Relationships and Specific Engagements	Acceptance and Continuance of Client Relationships and Specific Engagements	March 2020	B.8	Appendix 2 - Other additional comments	<ul style="list-style-type: none"> Streamlined requirements (see explanation of streamlining in box below). Adjusted quality objectives to be more outcome-based. Reduced the length of the application material by removing non-essential material and added examples to boxes to improve readability.
Engagement Performance	Engagement Performance	December 2019	B.3, B.7	Appendix 2 - Other additional comments	<ul style="list-style-type: none"> Streamlined requirements (see explanation of streamlining in box below). Adjusted quality objectives to be more outcome-based.

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		March 2020	B.9		<ul style="list-style-type: none"> Reduced the length of the application material by removing non-essential material and added examples to boxes to improve readability.
Resources	Resources	March 2020	B.10	Appendix 2 – Question 9	<ul style="list-style-type: none"> Streamlined requirements (see explanation of streamlining in box below). Adjusted quality objectives to be more outcome-based. Relocated service providers to this component, and adapted the requirements to a quality objective (see service providers below). Clarified the scope of technological resources that form part of the firm’s SOQM and provided guidance to demonstrate how the technological resources may vary depending on the nature and circumstances of the firm (see paragraph A125). Reduced the length of the application material by removing non-essential material and added examples to boxes to improve readability.
Information and Communication	Information and Communication	March 2020	B.11	Appendix 2 – Question 10	<ul style="list-style-type: none"> Streamlined requirements (see explanation of streamlining in box below). Removed reference to transparency reports in the requirements and retained the reference in application material in order to be more principles-based and focused on the firm’s proactive and timely communication externally, whatever the form, and to facilitate further innovation in external communications (see paragraph 40(c)(iv)). (It is noted that transparency reports were optional in ED-ISQM 1)

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					<ul style="list-style-type: none"> Enhanced the application material setting out the factors the firm considers in determining whether it is appropriate to communicate with external parties, and if so, the nature, timing and extent of such communication (see paragraph A146). Reduced the length of the application material by removing non-essential material and added examples to boxes to improve readability.
	Specified Responses (new section)	December 2019	B.3		<ul style="list-style-type: none"> Responses relocated from the components to a separate section, because some of the responses relate to matters in more than one component. Given that only five responses remain, and the grouping of the responses into one section, it is evident that firms need to design and implement responses in addition to those in the standard. The revised approach also encourages firms to focus on the quality objectives of each component, making the standard more principles-based and scalable to the nature and circumstances of the firm and engagements it performs.
		March 2020	B.12		
Monitoring and Remediation Process	Monitoring and Remediation Process	September 2019	C.1		<ul style="list-style-type: none"> Adjusted the requirement to specify that the firm needs to establish a monitoring and remediation process, to clarify that it is a process by nature (see paragraph 42). Enhanced the risk-based approach in monitoring and remediation by directly stating the quality risk for monitoring activities (i.e., to prevent or detect deficiencies that, individually or in aggregate, could result in the system of quality management not providing the firm with reasonable assurance that the objectives of the system are being
		December 2019	B.4	Appendix 2 – Question 12	
		March 2020	B.2		

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					<p>achieved) (see paragraph 44). The intent is that the increased focus on risk will encourage a proactive and preventative approach to monitoring, improve robustness and timeliness of monitoring, and address scalability.</p> <ul style="list-style-type: none"> • With respect to the inspection of completed engagements: <ul style="list-style-type: none"> ○ Revised the requirement and application material addressing the selection of completed engagements for inspection, to focus on a risk-based selection, and taking into account other monitoring activities the firm undertakes (see paragraph 45 and A168–A170). ○ Adjusted the application material suggesting a three-year cycle for the selection of engagement partners to demonstrate how a cycle may be flexed because of risk (see paragraph A169A). ○ Removed reference to inspection of in-process engagements, as it was not required (it is optional for firms). • In addition to the revisions to the definition of deficiencies and the new definition for findings, clarified the framework for evaluating findings and identifying deficiencies by: <ul style="list-style-type: none"> ○ Adding new application material that emphasizes that determining whether findings are deficiencies is a matter of professional judgment (see paragraph A173A). ○ Explaining the iterative nature of evaluating findings and identifying deficiencies and investigating the root cause(s) of identified deficiencies (see paragraphs A173A and A175A).

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					<ul style="list-style-type: none"> Enhanced the application material to explain how contrasting circumstances may be useful in investigating root cause(s) (see paragraph A181A). Moved “evaluating the system of quality management” to a separate section towards the end of the standard, to improve the focus of the evaluation on the SOQM as a whole, and to emphasize that the evaluation is the responsibility of leadership. Reduced the length of the application material by removing non-essential material and added examples to boxes to improve readability.
Network Requirements or Network Services	Network Requirements or Network Services	December 2019	B.8	Appendix 2 – Question 13	<ul style="list-style-type: none"> Enhanced the requirement addressing the information that the firm obtains from the network to include information about how the network determines that network requirements have been appropriately implemented across the network firms. The intent of the enhanced requirement is to encourage a focus on appropriate implementation across the network (see paragraph 61(a)). Clarified how the network requirements or networks services may need to be adapted or supplemented, as well as the work effort needed to support the evaluation of network requirements and network services (see paragraphs 58, 59 and A197) Simplified the requirements, including removing the link to the firm’s risk assessment process and reducing the prescriptiveness (see paragraphs 59 and 62).
		March 2020	B.13		

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					<ul style="list-style-type: none"> Clarified the firm’s responsibilities related to deficiencies in the network requirements or network services, and also to improve consistency with the monitoring and remediation component (see paragraph 62). Clarified 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, and how the information from the network may be shared by the firm with engagement teams (see paragraph A201).
Service Providers <i>(Removed)</i>		March 2020	B.10	Appendix 2 – Question 14	<ul style="list-style-type: none"> Relocated service providers to resources, through adapting the requirements into a quality objective in resources. This adjustment was made as service providers provide resources and all of the other quality objectives addressing resources also apply to service providers (see paragraph 38(g)). Furthermore, locating service providers in resources clarifies that they are subject to the risk-based approach. Simplified the application material given concerns about the practicality of the guidance (see paragraphs A134A–A134E).
	Evaluating the System of Quality Management <i>(new section)</i>	December 2019	B.5	Appendix 2 – Question 12(e)	<ul style="list-style-type: none"> Relocated from the “monitoring and remediation” component to reinforce leadership’s responsibility and accountability for the SOQM. Added application material to clarify the purpose of the evaluation (i.e., to emphasize leadership’s responsibility), and that “reasonable assurance” in the context of the evaluation is not an independent or external form of assurance.
		March 2020	B.3		

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					<ul style="list-style-type: none"> • Clarified the requirement and expectation on leadership by separating it into two parts: <ul style="list-style-type: none"> ○ Leadership’s evaluation of the SOQM, i.e., gathering and considering the information (see paragraph 65A). ○ Leadership’s conclusion on whether the SOQM provides the firm with reasonable assurance that the objectives of the SOQM are being achieved (see paragraph 65AA). • With respect to the timing of the evaluation: <ul style="list-style-type: none"> ○ Streamlined the requirement addressing the frequency of the evaluation of the SOQM to focus on the minimum frequency for the evaluation (annually) and to align with other changes to the requirements and application material (see paragraph 65A). ○ Clarified that the evaluation is undertaken at a point in time to provide consistency in interpretation of the requirement (i.e., that the evaluation is intended to provide leadership with an indication of whether the SOQM provides the firm with reasonable assurance that the objectives of the system <u>are being achieved</u>). • Added application material to explain the matters that may be considered by leadership in concluding on the SOQM to provide consistency in application of the requirement (see paragraph A210A). • Relocated the requirement for the performance evaluations of leadership from governance and leadership to this section, to

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					reinforce that the outcome of the evaluation of the SOQM may reflect how leadership has performed.
Documentation	Documentation	March 2020	B.14	Appendix 2 - Other additional comments	<ul style="list-style-type: none"> Enhanced the emphasis on the need for professional judgment in determining appropriate documentation (see paragraph A212). Clarified that the firm is not required to document every factor that was taken into account in identifying and assessing quality risks (see paragraph A214).

Other Feedback from Respondents not Specifically Related to the Components in the Table Above

Topic	Issues Paper in Which Feedback is Summarized	Section of Issues Paper Summarizing Respondent Feedback
Quality management approach, benefits of ED-ISQM 1 and scalability	September 2019	B.1 (Question 1)
Implementation challenges	September 2019	B.2 (Question 2)
Components and structure of ED-ISQM 1	September 2019	B.3 (Question 4)
Application material	December 2019	Appendix 2 – Question 3
The appendix	December 2019	Appendix 2 - Other additional comments
Change in title to “ISQM”	March 2020	Appendix 2 – Question 15

Explanation of the Revisions to the Components to Streamline the Quality Objectives and Responses

1. Grouping quality objectives, where appropriate.
2. Reducing duplication between quality objectives and responses. Where this was the case, for the most part the responses were subsumed into the quality objectives.
3. To the extent that a response directly related to a quality objective, combining the quality objective and response.
4. Relocating more granular aspects of the requirements to application material, where appropriate.