

## Proposed ISQM 1<sup>1</sup>: Issues and Recommendations

### Overview

In December 2019, the IAASB discussed proposals on certain aspects of proposed ISQM 1, including feedback from respondents to the Exposure Draft (ED) of ISQM 1 (ED-ISQM 1) in relation to certain questions. The discussion focused on the approach to quality risk considerations, how quality objectives and responses should be addressed in the standard, monitoring and remediation, the evaluation of the system of quality management (SOQM) and networks. Furthermore, the ISQM 1 Task Force (TF) continued its discussions with the IAASB on the issues of scalability, tailoring, complexity, prescriptiveness and applicability of proposed ISQM 1 to all firms.

Since December 2019, the ISQM 1 TF has considered the Board's feedback, and has also considered respondents' views on other aspects of ED-ISQM 1 not previously presented to the Board, including the objective of the standard and references to public interest, relevant ethical requirements, resources, information and communication and service providers.

Given that all of the feedback from respondents on ED-ISQM 1 relating to the standard has now been considered by the ISQM 1 TF, a full draft of the standard has been prepared for discussion with the Board in March 2020. The ISQM 1 TF's plan is to finalize the standard in June 2020.

### Key Focus Areas for the IAASB Discussion in March 2020

In order to achieve the finalization of proposed ISQM 1 in June 2020, it is critical that the ISQM 1 TF has clear direction from the IAASB on the following matters:

- (a) The approach to the identification and assessment of quality risks in the firm's risk assessment process (section B.1) *(previously discussed with the Board)*.
- (b) With respect to monitoring and remediation (section B.2) *(previously discussed with the Board)*:
  - (i) The definition of findings and the application material supporting the definition of deficiencies; and
  - (ii) The requirements addressing the inspection of completed engagements.
- (c) The approach to firm leadership's annual evaluation of the SOQM (section B.3) *(previously discussed with the Board)*.
- (d) The scope of relevant ethical requirements (section B.7).
- (e) How service providers are addressed in the standard (section B.10).
- (f) How transparency reports are addressed in proposed ISQM 1 (section B.11).
- (g) With respect to the effective date of proposed ISQM 1, what firms will be expected to have in place by the date determined by the Board (section B.16).

<sup>1</sup> Proposed International Standard on Quality Management (ISQM) 1 (Previously International Standard on Quality Control (ISQC) 1), *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*

In addition to the above matters, this issues paper includes an explanation of other proposals of the ISQM 1 TF on which Board input is being sought.

**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 December 2019; and
  - (b) Comments on the following questions in ED-ISQM 1 that were not previously presented to the Board:
    - (i) Question 5: Objective of the standard and reference to public interest in the standard;
    - (ii) Question 8 and related sub-questions: Responsibility for independence and relevant ethical requirements and network independence;
    - (iii) Question 9: Technology;
    - (iv) Question 10: Communication with external parties;
    - (v) Question 14: Service providers;
    - (vi) Question 15: Change in title to “ISQM”; and
    - (vii) Other additional comments on areas of ED-ISQM 1 that were not related to a specific question, including definitions, relevant ethical requirements, acceptance and continuance and documentation.

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

2. The summary of respondents’ feedback presented in [Agenda Item 4](#) of the September 2019 meeting, [Agenda Item 7](#) of the December 2019 meeting and in this paper have addressed all questions in ED-ISQM 1, except for respondent comments on support material, which will be presented in June 2020. A tracking list of the questions in ED-ISQM 1 and when they were presented to the IAASB is included in **Appendix 6**.

*Appendices to this Paper and Other Agenda Items Accompanying This Paper*

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

<b>Appendix 1</b>	Overview of the ISQM 1 TF’s activities
<b>Appendix 2</b>	Overview of the responses to the questions in ED-ISQM 1 addressed in this paper
<b>Appendix 3</b>	How the proposals address the key areas of concern
<b>Appendix 4</b>	Transparency reports – further information gathering
<b>Appendix 5</b>	Networks outreach – overview of feedback from the networks about the effect of proposed ISQM 1 at the network level
<b>Appendix 6</b>	Tracking list of the questions in ED-ISQM 1 and when they were presented to the IAASB

<b>Appendix 7</b>	List of respondents to ED-ISQM 1
<b>Appendix 8</b>	Draft minutes of the December 2019 IAASB discussion
<b>Agenda Item 4-A</b>	Draft of proposed ISQM 1 (Clean)
<b>Agenda Item 4-B</b>	Draft of proposed ISQM 1 (Marked from ED-ISQM 1 and December 2019 IAASB meeting)
<b>Agenda Item 4-C.1</b>	Nvivo summary of analysis of each question or topic (Excel)
<b>Agenda Item 4-C.2 – Agenda 4-C.8</b>	Nvivo report for each question or topic (Word)
<b>Agenda Item 4-D (For Reference)</b>	Tracking of changes to proposed ISQM 1 from ED-ISQM 1

*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 proposed ISQM 1 (**Agenda Item 4-A**).
5. Section B has been organized to first address the firm’s risk assessment process, monitoring and remediation and the evaluation of the SOQM, as these sections include more pervasive issues to the standard as a whole. The remainder of Section B then follows the sequential order of the standard. The introduction of this paper includes a “blue box” which highlights the key focus areas for the IAASB discussion in March 2020.

**B. ISQM 1 TF’s Proposals on Proposed ISQM 1**

6. This section sets out the ISQM 1 TF’s proposals that have been developed to address:
  - (a) The feedback from the Board discussion in December 2019, and written comments provided by Board members in December 2019; and
  - (b) Comments on the questions in ED-ISQM 1 that have not previously been discussed by the Board.
7. Furthermore, in developing the proposals in **Agenda Item 4-A**, the ISQM 1 TF has continued to focus on the following key areas of concern raised by respondents:
  - (a) The scalability of the standard and encouraging firms to appropriately tailor 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.

**Appendix 3** provides an overview of how the revisions to proposed ISQM 1 address these concerns (**Appendix 3** was presented to the Board in December 2019 and has been updated to reflect the proposals to be discussed in March 2020).

**B.1 The Firm’s Risk Assessment Process and the Approach to Quality Objectives and Responses in the Components**

Relevant Paragraphs in Agenda Item 4-A			
Requirements	Application Material	Definitions	Other
22C–22G	A24F–A24Y	19(p), 19(q), 19(t), A17 and A18	

*The Overall Approach to the Firm’s Risk Assessment Process and the Quality Objectives and Responses in the Components*

8. The ISQM 1 TF focused on the fundamental principle that the firm’s risk assessment process drives the SOQM. As a result, the robustness of the firm’s risk assessment process has been enhanced by outlining the factors that may adversely affect the achievement of the quality objectives (previously described as quality risk considerations). In addition, and to address concerns from respondents about the prescriptiveness and scalability of ED-ISQM 1:
  - (a) The quality objectives in the components have been reviewed and revised to be outcome-based; and
  - (b) Some responses have been relocated to the outcome-based objectives to place more focus on the quality objectives, and signal that firms need to achieve the quality objectives (i.e., a prescribed response drives less of a risk-based, tailored approach based on the nature and circumstances of the firm).
9. As a result of the changes to the firm’s risk assessment process and the quality objectives, the need for prescribed responses in the standard has been reduced, because the responses are addressed through the need for the firm to achieve the quality objectives. The nature of the remaining responses in the standard (paragraph 41A of **Agenda Item 4-A**) were not suitable to be quality objectives, and therefore are requirements for the firm as part of their SOQM.

*Quality Risk Considerations*

10. In December 2019, the ISQM 1 TF introduced the concept of “quality risk considerations.” In light of the Board’s general support and further suggestions, the ISQM 1 TF:
  - (a) Agreed that the quality risk considerations are the same as conditions, events, circumstances, actions or inactions that may adversely affect the achievement of the firm’s quality objectives; and
  - (b) Considered whether to use the word “factors” to describe the conditions, events, circumstances, actions or inactions. The ISQM 1 TF agreed that it is helpful to use a shorter term (i.e., “factors”) because multiple references are made throughout the standard to the factors.

11. Given these changes, the ISQM 1 TF also:
  - (a) Revised the examples of the factors in the application material to better reflect how they may relate to conditions, events, circumstances, actions or inactions (see example box in paragraph A24N of **Agenda Item 4-A**). The ISQM 1 TF is of the view that this will further assist firms in identifying and assessing quality risks.
  - (b) Removed the definition of quality risk considerations, updated the definition of quality risks, and updated all other references to quality risk considerations.
12. The ISQM 1 TF also acknowledged the suggestion during the December 2019 discussion to further clarify the relationship between the quality risk considerations (i.e., factors) and identifying and assessing the quality risks. To address this, a new consideration has been added in paragraph 22E(b)(i) of **Agenda Item 4-A** that requires the firm to consider whether, and if so, how the factors could affect the achievement of a quality objective. The ISQM 1 TF is of the view that this addition will assist firms in thinking through the risk identification and assessment process and adds emphasis that not all factors give rise to quality risks.
13. Other revisions that have been made to the requirements and application material dealing with the identification and assessment of quality risks include:
  - (a) Adding factors in paragraph 22E(a) of **Agenda Item 4-A** or examples of factors in the application material (see paragraph A24N of **Agenda Item 4-A**) to include matters suggested by the Board in December 2019, such as business model, commercial considerations and resources.
  - (b) Emphasizing that there may be factors in addition to those described in the standard that may adversely affect the achievement of a quality objective (see paragraph A24N of **Agenda Item 4-A**).
  - (c) Removing the application material with examples of quality risk considerations that was included in the various components of proposed ISQM 1 in the December 2019 draft.

*Other Changes Proposed to the Firm's Risk Assessment Process and Related Definitions*

14. The following revisions have also been made in **Agenda Item 4-A**:
  - (a) The definition of quality risks in paragraph 19(q) has been revised to more directly refer to likelihood and magnitude, as proposed by the Board in December 2019. The related application material was also removed, as it was duplicative of the definition.
  - (b) The description in paragraph 22F regarding the completeness of the specified responses has been removed, since there are only a few specified responses remaining in the standard and the ISQM 1 TF is of the view that based on the overall changes to the firm's risk assessment process, it was no longer necessary to make this statement.
  - (c) With respect to paragraph 22G (and paragraph 22H in the December 2019 draft) and the related application material:
    - (i) The ISQM 1 TF has separated the modification of quality objectives, from the modification of quality risks and responses to clarify that the modification of quality objectives comprises establishing additional quality objectives. This is to address the

Board's concerns that the quality objectives set out in the standard are required and should not be modified.

- (ii) The paragraphs have been streamlined. In particular, given that paragraph 49 already addresses modifications arising from deficiencies, it does not need to be repeated in the firm's risk assessment process. Instead, the application material (paragraph A24X) makes reference to the requirement in monitoring and remediation.
- (iii) Paragraph A24VA clarifies the intent of the explanation, and how the requirements of paragraph 22G are scalable, given various written comments provided by Board members.

**Matters for IAASB Consideration**

1. Does the IAASB support the proposals addressing the identification and assessment of quality risks, in particular:
  - (a) Adjusting the quality risk considerations to "factors," which are intended to be conditions, events, circumstances, actions or inactions?
  - (b) Revising the examples in paragraph A24N of **Agenda Item 4-A** to demonstrate how the nature and circumstances of the firm and the engagements it performs are related to conditions, events, circumstances, actions or inactions?
  - (c) The addition of the requirement in paragraph 22E(b)(i) of **Agenda Item 4-A** that addresses considering whether and how the factors could affect the achievement of the quality objectives?
  - (d) The revisions to the definition of quality risks in paragraph 19(q) of **Agenda Item 4-A** to directly include likelihood and magnitude?
2. Is the IAASB of the view that the changes to the firm's risk assessment process are responsive to the Board comments in December 2019?

**B.2 Monitoring and Remediation**

Relevant Paragraphs in Agenda Item 4-A			
Requirements	Application Material	Definitions	Other
42–54	A154–A186	19(a), 19(g), 19(gA) and A9A–A10A, A11A	N/a

*Findings and Deficiencies*

Definition of Deficiencies

15. The ISQM 1 TF noted the IAASB's general support for the definitions of "deficiencies." However, in evaluating the written comments provided by the Board in December 2019, it was noted that there were different interpretations of the meaning of "aspect." The ISQM 1 TF considered other terms to describe "aspect," however noted that further clarifying this term in the definition would result in a description similar to ED-ISQM 1, which was considered overly detailed. The ISQM 1 TF therefore

resolved to retain the term “aspect,” however clarify its meaning in application material (see paragraph A10 of **Agenda Item 4-A**).

16. Recognizing that there are various aspects of the SOQM that could be deficiencies, but which are not linked to quality objectives, quality risks or responses in proposed ISQM 1, the description of aspects includes “other actions by the firm that are necessary to fulfill the requirements of this ISQM” (i.e., the firm’s risk assessment process, monitoring and remediation process and the various requirements in paragraphs 22A–22B of **Agenda Item 4-A**).

#### Definition of Findings

17. The ISQM 1 TF noted the Board’s support for the definition of findings. However, written comments provided by the Board in December 2019 sought clarity on the meaning of “information accumulated from the performance of monitoring activities or derived from other information sources.” Therefore, revisions have been made to paragraph 19(gA) of **Agenda Item 4-A** to be clearer about what information is intended. Furthermore, as suggested by the Board in December 2019, the last part of the definition has been removed.
18. With these revisions, the ISQM 1 TF determined that paragraphs A11A and A172 of the December 2019 draft (see **Agenda Item 4-B**) are no longer needed due to the change in definition of findings. Similarly, paragraph 47 of **Agenda Item 4-A** has been streamlined because of the updates to the definition.

#### Determining Whether Findings are Deficiencies

19. The ISQM 1 TF acknowledged the Board’s suggestion to explore whether further clarification could be provided of how the firm determines that findings are deficiencies. The ISQM 1 TF is of the view that the proposed definitions, together with the application material in paragraphs A173–A177 of **Agenda Item 4-A** (in particular paragraph A175), provide clarity in determining whether findings are deficiencies. The ISQM 1 TF notes that firms will need to exercise professional judgment, and that the determination of whether findings are deficiencies will depend on a number of factors, which are included in the standard.

#### Inspection of Completed Engagements

20. As recommended by the Board in December 2019, the ISQM 1 TF has revised the requirement in paragraph 45 of **Agenda Item 4-A** and added application material (see paragraph A168B of **Agenda Item 4-A**) to emphasize that the selection of completed engagements for inspection is affected by the nature, timing and extent of other monitoring activities undertaken by the firm. In particular, the standard:
  - (a) Emphasizes that the firm may perform a variety of other monitoring activities, some of which may have been undertaken on certain engagements or engagement partners.
  - (b) Explains how other monitoring activities may therefore affect the inspection of completed engagements.

The ISQM 1 TF is of the view that this material increases the emphasis on the firm considering its overall combination of monitoring activities, thereby providing improved flexibility for firms in determining the appropriate cycle for the inspection of completed engagements for engagement partners.

21. The ISQM 1 TF noted the mixed views from the Board regarding the proposed removal of the reference to a three-year cycle in the application material supporting the inspection of completed engagements, and the suggestion to increase the emphasis on the selection of completed engagements based on risk.
22. In order to improve the focus on the selection of engagements based on risk:
  - (a) The lead-in of paragraph 45 of **Agenda Item 4-A** has been revised to refer to the considerations in paragraph 44 of **Agenda Item 4-A** so that it is clearer that the considerations in paragraph 44 also apply to selection of completed engagements for inspection.
  - (b) Paragraph A168 of **Agenda Item 4-A** explains how the considerations in paragraph 44 may be considered by the firm in selecting completed engagements for inspection, and the examples include considerations related to engagement partners.
  - (c) An example has been added to explain how the firm may apply a cyclical basis for the inspection of completed engagements for each engagement partner, which demonstrates circumstances when an engagement partner may need to be selected more frequently due to risk (see paragraph A169A of **Agenda Item 4-A**). Furthermore, this example emphasizes the need for unpredictability in the selection of engagements for engagement partners, which is an important element of addressing risk.
23. The ISQM 1 TF is of the view that the example in paragraph A169A of **Agenda Item 4-A** addresses the differing views of the board regarding the reference to a three year cycle for the selection of engagements for engagement partners, since although it refers to a three year cycle, the emphasis is on the firm flexing the cycle as appropriate (i.e., more frequently (e.g., due to risk), or less frequently because the firm has enough evidence about the engagement partner). The ISQM 1 TF believes that an explanation of how the cycle may vary is necessary to demonstrate that the standard is scalable (upwards and downwards) and it encourages proactive quality management (i.e., firms inspect engagements of engagement partners more frequently in cases where it is appropriate to do so).
24. The ISQM 1 TF considered the Board's proposal to remove the reference to "completed engagements" in the first sentence of paragraph 45 of **Agenda Item 4-A**. However, the intent of paragraph 45 is to set the *minimum* requirements for the inspection of engagements, and the ISQM TF's view is that in-process inspections are unlikely be a replacement for inspection of completed engagements. Therefore, by removing the term "completed," it might blur the intent of the paragraph. The ISQM 1 TF notes that the standard does not preclude the firm from performing inspection of in-process engagements, and, as described above in paragraph 20, increased emphasis has been made in the standard that the selection of completed engagements for inspection is affected by the nature, timing and extent of other monitoring activities undertaken by the firm.

#### *Other Changes to Monitoring and Remediation*

25. In response to Board feedback and other outreach, other changes that have been made to monitoring and remediation in **Agenda Item 4-A** include:
  - (a) Paragraph 44 has been adjusted in response to the Board's suggestions in December 2019 to incorporate a more proactive and preventative tone in describing the quality risk, and to refer to the combination of ongoing and periodic monitoring activities.



- (b) Paragraph A154 was reinstated to link monitoring and remediation with the evaluation of the SOQM, in response to the Board's suggestion in December 2019. It is also noted that paragraph A183A creates a link to the evaluation of the SOQM.
  - (c) Paragraph A165 was amended to include information from other regulators, given feedback from the ISQM 1 TF's recent outreach with monitoring group (MG) members.
  - (d) Paragraph A179 has been clarified to emphasize that that the investigation of the root cause(s) may assist the firm in evaluating the severity and pervasiveness of the deficiencies, since written comments provided by Board members inquired about the sequencing of undertaking the root cause analysis and evaluating the severity and pervasiveness of deficiencies.
  - (e) Paragraph A181A was added to clarify how the firm's consideration of why deficiencies did not arise in other circumstances may assist the firm in investigating root causes of identified deficiencies.
  - (f) Paragraph A184B was added given the restructuring of the provisions addressing service providers (see Section B.10 of this paper).
  - (g) Paragraph 50 has been enhanced to require that the individuals take appropriate action.
26. The ISQM 1 TF considered the Board's comment that this component has extensive requirements giving rise to scalability concerns. However, the ISQM 1 TF notes that it has been set up as a process in proposed ISQM 1, and that scalability has been embedded in the requirements (e.g., paragraph 44 of **Agenda Item 4-A** drives the firm to consider risks in determining the nature, timing and extent of the monitoring activities). The matters addressed in this component have been included to retain requirements from extant ISQC 1,<sup>2</sup> or to address input and feedback from stakeholders since the initiation of the project. As a result, while recognizing the feedback from the Board, the ISQM 1 TF has not identified any requirements in this component that could be removed, and at the same time maintain the robustness of the standard. Accordingly, the ISQM 1 TF is of the view that the requirements as drafted provide a framework for a robust monitoring and remediation process.

#### **Matters for IAASB Consideration**

- 3. Does the IAASB support the proposed revisions to the definitions related to monitoring and remediation, in particular:
  - (a) The revised application material supporting the definition of deficiencies to clarify the meaning of "aspect" in the definition (paragraphs 19(a) and A9A–A10A of **Agenda Item 4-A**)?
  - (b) The revisions to the definition of findings (paragraph 19(gA) of **Agenda Item 4-A**)?
- 4. Does the IAASB support the approach to addressing the inspection of completed engagements (paragraphs 45 and A168–A170 of **Agenda Item 4-A**)?
- 5. Is the IAASB of the view that the remaining changes to monitoring and remediation are responsive to the Board comments in December 2019?

<sup>2</sup> ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance and Related Services Engagements*

### B.3 Evaluation of the SOQM

Relevant Paragraphs in Agenda Item 4-A			
Requirements	Application Material	Definitions	Other
65A–65D	A209A–A210G	19(r)	N/a

27. The ISQM 1 TF noted the Board’s suggestion to explain that the SOQM may still be effective despite having deficiencies. The ISQM 1 TF is of the view that deficiencies should not be unexpected to occur in a firm’s SOQM, because of the inherent limitations of any SOQM. Furthermore, the identification of deficiencies by the firm is a necessary and important aspect of the SOQM, because prompt identification of deficiencies enables the firm to rectify them in a timely and effective manner, and contributes to a culture of learning and improvement. Accordingly, the ISQM 1 TF is conscious that in developing the requirements for the evaluation of the SOQM, caution is needed so that firms are not discouraged from identifying and remediating deficiencies; instead it should encourage a continual improvement mindset where the identification of deficiencies is constructive to the overall SOQM.
28. The ISQM 1 TF noted the comments from respondents seeking clarification about the timing of the evaluation (i.e., whether the annual evaluation is an ongoing evaluation or a point-in-time evaluation, whether it is based on a “period ended” or an “as of date” and when the evaluation should be undertaken more frequently than annually). In response to these comments, the ISQM 1 TF has proposed:
- (a) Streamlining the requirement addressing the frequency of the evaluation of the SOQM to focus on the minimum frequency for the evaluation. The ISQM 1 TF noted that in circumstances when the firm has established that the deficiencies are severe or pervasive, the firm is required to take appropriate and timely remedial action in accordance with paragraphs 49–50 of **Agenda Item 4-A**. As a result, undertaking a formal evaluation of the SOQM would unlikely drive a different response by the firm. Furthermore, requiring an evaluation to be undertaken when severe or pervasive deficiencies are identified would contradict the matters described in paragraph A210A of **Agenda Item 4-A** in evaluating the system (i.e., as explained in paragraph 30 below, leadership considers the combination of these matters, and therefore when a deficiency that is severe or pervasive is identified, time is needed for the firm to initiate remediation actions and correct the effect of the deficiency).
  - (b) Including an explicit statement that the evaluation is undertaken at a point in time (see paragraph 65A of **Agenda Item 4-A**). This is supported by corresponding changes to describe the evaluation in the context of whether the SOQM “provides the firm with reasonable assurance that the objectives of the SOQM *are being* achieved.” Application material has also been added in paragraph A209B of **Agenda Item 4-A** to provide examples of the point in time when the evaluation may be undertaken.
29. The ISQM 1 TF is of the view that in order to enhance the clarity of the evaluation and the expectation on leadership, it is best to separate the requirement into two parts, i.e.:
- (a) Leadership’s evaluation of the SOQM, i.e., gathering and considering the information.
  - (b) Leadership’s conclusion on whether the SOQM provides the firm with reasonable assurance that the objectives of the SOQM are being achieved.

30. Application material has been added to explain the matters that may be considered by leadership in concluding on the SOQM (see paragraph A210A of **Agenda Item 4-A**). These include:
- (a) The severity and pervasiveness of identified deficiencies, and the effect on the achievement of the objectives of the SOQM. In this regard, the ISQM 1 TF identified that the concept of severe and pervasive is used in ISA 705 (Revised).<sup>3</sup> The ISQM 1 TF is of the view that, consistent with those concepts, there may be instances when:
    - (i) The deficiencies are severe but not pervasive, in which case leadership may conclude that except for the matter to which the deficiency relates, the SOQM provides the firm with reasonable assurance that the objectives of the SOQM are being achieved.
    - (ii) The deficiencies are severe and pervasive, in which case leadership may conclude that the SOQM does not provide the firm with reasonable assurance that the objectives of the SOQM are being achieved.
  - (b) Whether the deficiencies have been remediated, or how the remediation of the deficiencies is being addressed. This is consistent with the Board’s recommendations in December 2019.
  - (c) Whether the effect of identified deficiencies have been appropriately corrected. This is also consistent with the Board’s recommendations in December 2019.

It is intended that leadership considers the combination of these matters, i.e., a deficiency that is severe and pervasive that has been remediated and the effect of the deficiency corrected would unlikely lead leadership to conclude that the SOQM does not provide the firm with reasonable assurance that the objectives are being achieved.

31. Other changes proposed to the evaluation of the SOQM include the addition of paragraph A209A of **Agenda Item 4-A** to emphasize the responsibility of the firm for achieving the objectives of the SOQM, and the purpose of the evaluation of the SOQM

**Matters for IAASB Consideration**

- 6. Does the IAASB support the proposals addressing the evaluation of the SOQM, in particular:
  - (a) The introduction of a two-part approach, i.e., leadership’s evaluation of the SOQM and subsequent conclusion on the SOQM?
  - (b) The considerations supporting leadership’s conclusion on the SOQM, including the concepts explaining severity and pervasiveness?
- 7. Does the IAASB support the remaining changes to the evaluation of the SOQM?

**B.4 Introduction and Objective of Proposed ISQM 1**

Relevant Paragraphs in Agenda Item 4-A			
Requirements	Application Material	Definitions	Other
1–18	A1–A9	19(r)	N/a

<sup>3</sup> ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor’s Report*

32. Question 5 of ED-ISQM 1 asked for respondents' views on the objective of ED-ISQM 1 and how the standard addresses the firm's role relating to the public interest. The feedback from respondents is summarized in **Appendix 2**.

*Reference to Public Interest*

33. Overall, the ISQM 1 TF noted that there were mixed views regarding the reference to public interest in the standard, and is also aware that the Public Interest Oversight Board (PIOB) has, as one of its public interest issues, the need for the objective to include a focus on high quality audits. The ISQM 1 TF considered the various suggestions and comments from respondents including:

- (a) Adding references to the public interest in the objective of the standard or elsewhere in the requirements.

As recommended by a MG member, and in order to enhance the prominence of public interest, paragraph 7 of **Agenda Item 4-A** has been restructured, so that public interest is the first matter discussed in this paragraph (this ordering is also more consistent with how public interest is described in proposed ISA 220 (Revised)<sup>4</sup>).

Consistent with the explanations provided in the explanatory memorandum to ED-ISQM 1, the ISQM 1 TF is of the view that a reference to acting in the public interest in the objective, without common agreement on what the public interest means in this context, would impose an obligation on firms that is not capable of being consistently and objectively evaluated as achieved or not achieved.

- (b) Concerns about the wide interpretation of public interest.

The ISQM 1 TF noted that the concept of public interest is referenced elsewhere in the ISAs<sup>5</sup> and in the International Ethics Standards Board for Accountants (IESBA) *International Code of Ethics for Professional Accountants (including International Independence Standards)* (the Code), and paragraph A2 of **Agenda Item 4-A** makes reference to the Code. The ISQM 1 TF also noted that the description of the public interest in proposed ISQM 1 is in the context of the consistent performance of quality engagements, i.e., that quality engagements are integral to a firm's responsibility to act in the public interest. As a result, the ISQM 1 TF remains of the view that how proposed ISQM 1 refers to the public interest is appropriate.

- (c) Suggestions to refer to other frameworks that address public interest.

The ISQM 1 TF notes that the public interest framework being developed by the PIOB has not yet been completed. The ISQM 1 TF also discussed and concluded that it would be inappropriate to refer to IFAC Policy Position 5,<sup>6</sup> since references to the public interest in the ISAs and the IESBA Code do not make similar references.

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<sup>4</sup> Proposed ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*

<sup>5</sup> See, for example paragraph A18 of ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, and paragraph A25 of ISA 450, *Evaluation of Misstatements Identified during the Audit*.

<sup>6</sup> [IFAC Policy Position 5: A Definition of the Public Interest](#)

- (d) Recommendations to more clearly explain the link between the objective of the standard and public interest, or why the consistent performance of quality engagements serves the public interest.

The ISQM 1 TF has enhanced paragraphs 7 and 8A of **Agenda Item 4-A**, and some of the changes are intended to create an improved link with the objective of the standard.

#### *Objective of Proposed ISQM 1*

- 34. The ISQM 1 TF observed that, in general, respondents supported the objective of ED-ISQM 1. The ISQM 1 TF considered the individual comments from respondents including:

- (a) Those related to the meaning of reasonable assurance.

The ISQM 1 TF noted that clarifying the meaning of reasonable assurance would be best addressed through enhancements to the requirements and application material dealing with the evaluation of the SOQM. For example:

- (i) Paragraph A210DA of **Agenda Item 4-A** clarifies that the firm is not required to obtain an independent assurance report on its SOQM.
- (ii) Paragraph A210A explains factors that may be considered in concluding whether the SOQM provides reasonable assurance that the objectives of the system are being achieved.

With respect to the suggestion from a respondent that the SOQM should provide a level of assurance higher than reasonable assurance, the ISQM 1 TF observed that reasonable assurance is used and understood in other internal control frameworks, such as the COSO Integrated Framework,<sup>7</sup> and is also a concept well embedded in the IAASB's standards.

- (b) Concerns regarding the multiple layers of objectives and their interrelationship.

Paragraph 8A of **Agenda Item 4-A** has been enhanced to further clarify the objective of the standard and the objective of the system. In addition, the ISQM 1 TF proposes that the relationship be explained through illustrations in the implementation support materials that will accompany the standard.

#### *Other Changes Proposed to the Introduction*

- 35. In addition to various revisions to streamline and clarify the introduction, other revisions to the introduction of **Agenda Item 4-A** include:

- (a) Reinstating paragraph 10 of ED-ISQM 1 in response to the Board's suggestion to include this material in the introduction. Given the addition of paragraph 10, further revisions were needed to paragraph 9A.
- (b) Paragraph 14 was enhanced to clarify the difference between networks and service providers, in response to written comments provided by Board members.

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<sup>7</sup> Committee of Sponsoring Organizations of the Treadway Commission (COSO), *Internal Control – Integrated Framework*

**Matters for IAASB Consideration**

8. Does the IAASB support how proposed ISQM 1 addresses the firm's role in serving the public interest, including the enhancements to paragraph 7 of **Agenda Item 4-A** to bring greater prominence to it?
9. Does the IAASB agree with the view of the ISQM 1 TF that the objective of proposed ISQM 1 remains appropriate?
10. Does the IAASB support the remaining changes to the introduction of the standard?

**B.5 System of Quality Management**

Relevant Paragraphs in Agenda Item 4-A			
Requirements	Application Material	Definitions	Other
22–22B	A21–A24E	19(v)	N/a

*Integration of Quality Management into the Strategy, Operations and Business Processes*

36. During the December 2019 discussion, a Board member emphasized the need for quality management to be integrated into the strategy, operations and business processes of the firm, so that quality management does not become a separate compliance function. This member suggested that paragraph A21A of **Agenda Item 4-A** should be a requirement, and that operational responsibility for the SOQM should be assigned to the assurance leaders or audit leaders.
37. The ISQM 1 TF deliberated the comment and is of the view that proposed ISQM 1 addresses the integration of quality into strategic decisions and actions, including the firm's financial and operational priorities (see paragraph 23(a)(iv) of **Agenda Item 4-A**) and deals with the firm's organizational structure and assignment of roles and responsibilities (paragraph 23(d) of **Agenda Item 4-A**). The ISQM 1 TF also discussed that adding requirements to specify which firm leader should be assigned operational responsibility could inappropriately prescribe or restrict how the firm designs its operational processes.
38. However, in order to emphasize the point that the SOQM should not be a separate compliance function of the firm, paragraph A24CA of **Agenda Item 4-A** has been added to explain that the individuals assigned operational responsibility for the SOQM need to have an appropriate understanding of operational matters within the firm.

*Experience, Knowledge and Time of the Individual(s) Assigned Ultimate Responsibility for the SOQM*

39. A written comment provided by a Board member noted that the role of the firm's chief executive officer, managing partner or managing board of partners are predefined roles in a firm and do not exist solely for the purpose of the SOQM. However, the requirements in paragraphs 22A and 22AA of **Agenda Item 4-A**, as previously drafted, prescribed the qualifications of these individual(s).
40. The ISQM 1 TF is of the view that to ensure that there is appropriate emphasis on the SOQM, and a tone of quality across the firm, ultimate responsibility for the SOQM needs to be with the individual who is the most senior in the firm and who is responsible for key decisions that would impact the SOQM, such as how resources are assigned in the firm. The ISQM 1 TF believes that this approach

supports the public interest, rather than requiring firms to assign ultimate responsibility for the SOQM to individuals with the qualifications indicated in proposed ISQM 1 who may not have the highest level of authority in the firm. Accordingly, the ISQM 1 TF has proposed revisions to paragraphs 22A and 22AA of **Agenda Item 4-A** so that the qualification requirements are not linked to the individual(s) assigned ultimate responsibility for the SOQM, to ensure that the role is appropriately assigned.

*Other Changes Proposed to the Section “System of Quality Management”*

41. Other revisions made to this section in **Agenda Item 4-A** include the following:
- (a) Paragraph A22A was added to emphasize that although the responsibility and accountability for the SOQM is assigned to an individual, the firm is still overall responsible for the SOQM.
  - (b) Paragraph A24 was updated to align with the concepts described in the recent exposure draft issued by IESBA, [Proposed Revisions to the Code to Promote the Role and Mindset Expected of Professional Accountants](#). The comment period for this ED closed in October 2019. The ISQM 1 TF is coordinating with IESBA on aligning this material, and IESBA expects to finalize the revisions to the Code in June 2020.
  - (c) The example in paragraph A24B was revised, as certain pieces repeated the requirement and therefore appeared optional, while the description about the independent governing body was considered more relevant to governance and leadership (this piece has been relocated to paragraph A31A).

**Matters for IAASB Consideration**

- 11. Does the IAASB agree that proposed ISQM 1 addresses the relationship between quality management and strategy, operations and business processes, and that further requirements addressing how the firm designs its operational processes may be too prescriptive, in particular given the efforts to reduce the prescriptiveness of the standard?
- 12. Does the IAASB support the proposed revisions addressing the knowledge, experience and time of the individual(s) assigned ultimate responsibility for the SOQM?

**B.6 Governance and Leadership**

Relevant Paragraphs in Agenda Item 4-A			
Requirements	Application Material	Definitions	Other
23	A26–A35	N/a	N/a

42. Within the governance and leadership component, the changes that have been made in **Agenda Item 4-A** since the Board’s discussion in December 2019 include the following:
- (a) The quality objectives have been refined to articulate them in a more outcome-based manner. The ISQM 1 TF is of the view that an outcome-based objective is one that focuses on what results are to be achieved, rather than describing the process of how those results are achieved. As a result, the quality objectives were refocused on what it is about governance and leadership that needs to be achieved, instead of the actions of the firm.

- (b) The quality objectives addressing culture and leadership have been revised to address the Board feedback in December 2019 (see paragraphs 23(a), 23(a)(iii) and 23(c)).
- (c) Paragraphs 23(d) and 23(e) have been refined, in response to written comments provided by Board members in December 2019.
- (d) Paragraph A29 has been revised to explain how the firm's business model may influence incentive structures, and impact on quality, in response to the Board discussion in December 2019.

**Matter for IAASB Consideration**

13. Is the IAASB of the view that the changes to governance and leadership are responsive to the Board comments in December 2019?

**B.7 Relevant Ethical Requirements**

Relevant Paragraphs in Agenda Item 4-A			
Requirements	Application Material	Definitions	Other
32	A67–A75	19(s), A15-A16A	41A(a), 41A(b), A153B

43. Question 8 of ED-ISQM 1 asked for respondents' views on assigning responsibility for relevant ethical requirements and/or independence. The question also explored whether ED-ISQM 1 appropriately addressed the firm's responsibilities related to the independence of networks. Respondents also provided varying comments on other aspects of relevant ethical requirements. The feedback from respondents is summarized in **Appendix 2**.

*Responsibility for Relevant Ethical Requirements and/or Independence*

44. The ISQM 1 TF noted that, overall, respondents expressed mixed views about whether responsibility for relevant ethical requirements and/or independence should be assigned to an individual. The ISQM 1 TF also noted the feedback from respondents on ED-ISQM 1 as a whole, indicating concerns about the scalability and prescriptiveness of the standard.
45. The ISQM 1 TF is of the view that the standard should require the firm to assign responsibility for compliance with independence requirements to an individual, as proposed in ED-ISQM 1. This is due to the importance of independence to the performance of audit and assurance engagements and the expectation of stakeholders relying on the firm's reports that the firm is independent. The application material, which was added to the December 2019 draft of proposed ISQM 1, explains this point (see paragraph A153B of **Agenda Item 4-A**).
46. However, the ISQM 1 TF is of the view that including a further requirement in proposed ISQM 1 that requires the firm to assign responsibility for relevant ethical requirements would add too much prescription to the standard. Although the standard requires the firm to assign operational responsibility for independence and monitoring and remediation since these roles encompass responsibilities that are essential to the operation of the SOQM, firms should be given flexibility in further determining how to assign roles and responsibilities in the context of the nature and circumstances of the firm.



47. As part of its coordination activities with IESBA (see **Appendix 1**), the ISQM 1 TF shared the feedback from respondents and the ISQM 1 TF's proposals. IESBA Members and Staff participating in the discussion were overall supportive of the proposed way forward.

*The Firm's Responsibilities Related to the Independence of Networks*

48. The ISQM 1 TF noted that the majority of respondents supported how ED-ISQM 1 addresses the responsibilities of the firm regarding the independence of other firms or personnel within the network. Accordingly, the ISQM 1 TF proposes that no further revisions to the standard are needed to address this topic.

*Scope of Relevant Ethical Requirements*

49. In considering the feedback from respondents, the ISQM 1 TF observed the comment from a respondent related to the scope of relevant ethical requirements as defined, in particular the inclusion of Part 2 of the Code in the definition. As part of the coordination activities with IESBA (see **Appendix 1**), the ISQM 1 TF confirmed with IESBA Members and Staff how Part 2 of the Code applies. IESBA Members and Staff emphasized that Part 2 of the Code cannot be divorced from the remainder of the Code, and therefore is relevant to the performance of engagements. They also shared examples of when Part 2 of the Code could apply to the performance of engagements.
50. It is the view of the ISQM 1 TF that the relevant ethical requirements that should be considered by the firm in the context of a SOQM are those that apply in the context of engagements performed by the firm. For example:
- (a) There may be circumstances when an engagement partner pressurizes engagement team members or the engagement quality reviewer such that they could breach compliance with the fundamental principles of the Code. In such cases, Part 2 of the Code applies. Similarly, Part 2 of the Code includes provisions dealing with the preparation and presentation of information, which applies to personnel performing a compilation engagement (paragraph 300.5 A1 of the Code includes this as an example of the applicability of Part 2 of the Code to professional accountants in public practice).
  - (b) In relation to audits of group financial statements, the provisions in proposed ISA 600 (Revised)<sup>8</sup> address the responsibilities of the group engagement partner for the component auditors' fulfilment of ethical requirements that are relevant to the group audit. Given that the firm of the group engagement partner is responsible for the engagement and establishing a SOQM to support the performance of engagements, the firm of the group engagement partner is also responsible for the engagement team's compliance with relevant ethical requirements. To illustrate:
    - (i) When the firm is engaged to perform the group audit engagement, the firm's SOQM would support the group engagement partner in fulfilling the responsibility for relevant ethical requirements. The manner in which the SOQM may address component auditors would likely differ between component auditors who are personnel of the firm and are therefore subject to the firm's policies or procedures, and component auditors external to the firm.

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<sup>8</sup> ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

- (ii) When the firm performs work in the capacity of a component auditor, the individuals performing the work (component auditors) are subject to the ethical requirements that are relevant to the group audit engagement. The firm's SOQM cannot be expected to address personnel's fulfilment of the ethical requirements that are relevant to the group audit engagement, as this is a responsibility of the group engagement partner and the firm of the group engagement partner.
51. The ISQM 1 TF recommends that further clarification of the scope of the relevant ethical requirements would be helpful. In this regard, the following revisions have been made:
- (a) Application material has been added to explain how the scope of relevant ethical requirements applies in the context of personnel of the firm (see paragraph A16A of **Agenda Item 4-A**). This material was repurposed from paragraph A70 of ED-ISQM 1, and further clarified to explain why Part 2 of the Code may apply in the performance of engagements.
  - (b) The requirements in paragraph 32(a) of **Agenda Item 4-A** have been amended to emphasize that the relevant ethical requirements are those to which the firm and the firm's engagements are subject, given the clarity that has emerged from the discussions on proposed ISA 600 (Revised) on the applicability of relevant ethical requirements at the engagement level.
52. As part of its coordination activities with IESBA, the ISQM 1 TF shared the drafting of the definition of relevant ethical requirements and the relevant ethical requirements component with IESBA Members and Staff who participated in the coordination activities. The suggestions they provided to further clarify these aspects of the standard were considered by the ISQM 1 TF and the standard was adjusted accordingly.

*Other Changes Proposed to Relevant Ethical Requirements*

53. Other revisions to the requirements and application material in this component in **Agenda Item 4-A** relate to:
- (a) Refining the quality objectives and responses. In doing so, aspects of the responses have been included in the quality objectives and the quality objectives have been reorganized and streamlined, to address the perceived prescriptiveness of the standard. Only one specified response in this component remained and was relocated to the section "Specified Responses" in paragraph 41A (the specified responses also include the requirement to assign responsibility for independence to an individual).
  - (b) Removing or refining application material to reduce the length of the application material and relocating examples into boxes. In doing so, some revisions to drafting were necessary to convert certain explanations to examples.

**Matters for IAASB Consideration**

14. Does the IAASB agree that only explicit assignment of operational responsibility for compliance with independence requirements to a specified individual should be required?
15. Does the IAASB support the proposed changes to the relevant ethical requirements component, including the definition and related application material, in particular to clarify the scope of relevant ethical requirements for the firm's SOQM?

**B.8 Acceptance and Continuance**

Relevant Paragraphs in Agenda Item 4-A			
Requirements	Application Material	Definitions	Other
34	A77–A86	N/a	41A(d), A153E–A153G

54. There were no specific questions in ED-ISQM 1 related to acceptance and continuance, however various comments were made by respondents on this component. The feedback is summarized in **Appendix 2**.
55. The revisions to the requirements and application material in this component in **Agenda Item 4-A** relate to:
  - (a) Refining the quality objectives and responses to address the perceived prescriptiveness of the standard. In doing so, aspects of the quality objectives have been included in the specified responses (paragraph 41A(d)) and the quality objectives have been reorganized and streamlined. Some specific aspects of the quality objectives were moved to application material (see paragraph A83 of **Agenda Item 4-A**).
  - (b) Removing or refining the application material to reduce the length of the application material and relocating examples into boxes. In doing so, some revisions to drafting were necessary to convert certain explanations to examples.

**Matter for IAASB Consideration**

16. Does the IAASB support the proposed changes to the acceptance and continuance component?

**B.9 Engagement Performance**

Relevant Paragraphs in Agenda Item 4-A			
Requirements	Application Material	Definitions	Other
36	A92–A111	19(b), 19(n)	N/a

56. The ISQM 1 TF recognized the concern from the Board regarding the impact of the changes on proposed ISA 220 (Revised), which cascade to proposed ISA 600 (Revised). The ISQM 1 TF requested the ISA 220 TF to consider the provisions in this component, and to highlight areas where the requirements are incompatible, for further consideration by the ISQM 1 TF. Based on the feedback, the ISQM 1 TF is of the view that the standards are harmonious, since although proposed ISQM 1 no longer specifies responses, the quality objectives include the matters that need to be

addressed by the firm at the SOQM level, and which the engagement team may need to depend upon.

57. The changes that have been made to this component in **Agenda Item 4-A** since the Board's discussion in December 2019 include:
- (a) An adjustment to paragraph 36(b) to address the Board's suggestion that specific aspects of the requirements in ED-ISQM 1 had been inappropriately relocated to application material in the proposals presented in December 2019.
  - (b) Adding paragraph A93A to address a comment from a MG member (in relation to resources), which suggested that the standard could more robustly address service delivery centers.

**Matter for IAASB Consideration**

17. Does the IAASB support the proposed changes to the engagement performance component?

**B.10 Resources, Including Service Providers**

Relevant Paragraphs in Agenda Item 4-A			
Requirements	Application Material	Definitions	Other
38	A113–A134E	N/a	A184B

58. Question 9 of ED-ISQM 1 asked for respondents' views on whether ED-ISQM 1 had been appropriately modernized to address the use of technology. Respondents also provided various comments on other aspects of resources. Question 14 of ED-ISQM 1 asked for respondents' views about the proposals addressing service providers. The feedback from respondents is summarized in **Appendix 2**.

*Service Providers*

59. The ISQM 1 TF noted respondents' overall support for addressing service providers, however there were strong concerns about the scope of service providers contemplated by the standard, and the requirements being too onerous, particularly given possible challenges in obtaining information from the service providers.
60. The ISQM 1 TF remains of the view that, unlike network requirements and network services, service providers provide resources. The ISQM 1 TF agreed that resources from service providers could be used within any component of the SOQM, and that the firm needs to identify when resources from a service provider are needed. As a result, in the firm's risk assessment process, one of the factors the firm is required to consider in identifying and assessing quality risks is the resources of the firm, including those provided by service providers (see paragraph 22E(a)(i)(d) of **Agenda Item 4-A**). The intention is that this would trigger the firm to consider whether a service provider needs to be involved, and if a service provider is involved, whether or how that could affect the achievement of the quality objectives.

**Scope of Resources from Service Providers Subject to the Requirements in Proposed ISQM 1**

61. The ISQM 1 TF noted that the nature, timing and extent of the firm's responses to address service providers would depend on the assessed quality risks identified by the firm. For example, whether

the firm designs and implements responses, and the characteristics of the responses could vary depending on factors such as:

- (a) Whether the service provider is commonly known and the resource is an industry standard package, or whether it is has been customized for the firm.
- (b) How the resource would be used, what they would be used for, the extent of its use and the significance of its impact (e.g., a resource used to track staff allocations may be a lower risk than a resource used to perform engagements).
- (c) Whether the resource has been used by the firm for many years, or whether it has been recently utilized or acquired.

Examples of these factors have been included in the application material in paragraph A134B of **Agenda Item 4-A** to highlight that not all resources from service provides will necessitate a response.

- 62. Although the use of service providers is intended to be subject to the risk-based approach in proposed ISQM 1, the ISQM 1 TF observed that the separate section with requirements for service providers inadvertently implied that every service provider would be subject to the requirements. Accordingly, the ISQM 1 TF proposes addressing service providers within the resources component, so that it more clearly forms part of the risk-based approach. This proposal also improves the link between service providers and the other quality objectives in the resources component (the other quality objectives are still relevant to the resource from the service provider, as explained in paragraph A115 of **Agenda Item 4-A**).
- 63. In addition to the proposals above, paragraph A134A of **Agenda Item 4-A** further clarifies the resources from service providers that may be considered in the SOQM, in particular those used at the engagement level.

#### Practicality of the Requirements in ED-ISQM 1

- 64. Paragraphs 64–65 of ED-ISQM 1 and the related application material were explicit about the actions the firm should take when using a service provider. The ISQM 1 TF agrees with the concerns from respondents that it may not be practicable to obtain the extent of information from service providers suggested by the proposals, and that the approach should be more principles-based. The ISQM 1 TF is of the view that with the relocation of service providers to the resources component, and the explicit emphasis on the fact that the resources are also subject to the other quality objectives, service providers are appropriately and robustly addressed in the standard, without the need for prescriptive requirements similar to those in paragraphs 64–65 of ED-ISQM 1.
- 65. As a result, in relocating service providers to resources, in addition to the new quality objective in paragraph 38(g) of **Agenda Item 4-A**, the provisions from ED-ISQM 1 have been simplified, in particular:
  - (a) The requirements in paragraph 65 have been incorporated into paragraph A184B of **Agenda Item 4-A**.
  - (b) The application material previously located in paragraphs A205–A210 of ED-ISQM 1 have been simplified (see paragraphs A134A–A134E of **Agenda Item 4-A**).

### *Technological Resources*

66. The ISQM 1 TF noted the overall support for how ED-ISQM 1 has addressed technology, however there were concerns about the need to clarify the scope of technology contemplated by the standard. In order to address these concerns, paragraph A125 of **Agenda Item 4-A** has been amended to clarify the scope of technological resources that form part of the firm's SOQM, and to demonstrate how the technological resources may vary depending on the nature and circumstances of the firm. The examples also aim to address certain comments about the perceived lack of scalability of the technological resources requirements.

### *Use of Terms Related to Human Resources*

67. The ISQM 1 TF noted that, throughout proposed ISQM 1, there is inconsistent use of terms related to human resources. Among the terms used are "personnel," "individuals," and "human resources." The ISQM 1 TF noted that the term "personnel" is defined in proposed ISQM 1 and is linked to the definition of "staff" (i.e., personnel effectively means "partners and *professionals* the firm employs, including experts").
68. The ISQM 1 TF observed that the Code does not contain a definition of "personnel" and based on enquiries with IESBA Staff, the meaning of the term in the Code is dependent upon the context in which it is being used in the Code.
69. The ISQM 1 TF is of the view that given the environment in which firms operate, and the increasing use of other types of professionals and skills in performing engagements and operating the system, the reference to "professionals" may be outdated and limiting. Accordingly, the definition of "personnel" has been removed, so that the meaning of the term is approached in a manner consistent with the Code, i.e., personnel would have the meaning intended in the context in which it used.

### *Other Changes Proposed to Resources*

70. Other revisions to the requirements and application material in this component in **Agenda Item 4-A** include:
- (a) The quality objectives have been refined and rearticulated to make them more outcome-based.
  - (b) Application material has been removed or refined to reduce the length and examples have been relocated into boxes. In doing so, some revisions to drafting were necessary to convert certain explanations to examples.
  - (c) Paragraph A134 has been enhanced to address a comment from a MG member to emphasize the need to specify how individuals should interact with an IT application or apply intellectual resources.

#### **Matters for IAASB Consideration**

18. With respect to service providers:
- (a) Does the IAASB support relocating the previous requirements for service providers to resources?
  - (b) Does the IAASB support how the scope of service providers has been addressed and clarified?

- (c) Does the IAASB agree with the more risk-based approach for service providers (i.e., through the inclusion of a quality objective in the resources component)?
19. Does the IAASB support the proposals in paragraph A125 of **Agenda Item 4-A** to address the scoping of technological resources?
20. Does the IAASB support other proposed changes to the resources component?

**B.11 Information and Communication, Including Communication with External Parties**

Relevant Paragraphs in Agenda Item 4-A			
Requirements	Application Material	Definitions	Other
40	A135–A153	N/a	N/a

71. Question 10 of ED-ISQM 1 asked for respondents’ views on communication with external parties, including the proposals addressing transparency reports. The feedback from respondents is summarized in **Appendix 2**.

*Transparency Reports*

72. Paragraph 41(c)(iv) of ED-ISQM 1 did not contain a requirement for firms to publish a transparency report, however required firms to establish policies or procedures addressing communication to external parties, in a transparency report or otherwise, when the firm determines it appropriate to do so. The intention of this reference to transparency reports was to encourage firms to communicate externally via a transparency report when it is appropriate to do so.
73. The ISQM 1 TF acknowledged the mixed views from respondents on how ED-ISQM 1 deals with transparency reports. While certain respondents were concerned with explicitly stating “transparency report” in a requirement, mostly because it could imply that a transparency report is required in all circumstances, others were concerned that the requirement was not strong enough. The ISQM 1 TF also acknowledged the Public Interest Oversight Board’s (PIOB) recommendation that proposed ISQM 1 should require transparency reports and specify the minimum content of the reports.
74. The ISQM 1 TF is of the view that there was an underlying theme in respondents’ comments, i.e., that either transparency reports should be explicitly required, or not referenced in the requirement of the standard. The ISQM 1 TF noted that there was a lack of clarity in paragraph 41(c)(iv) of ED-ISQM 1 in terms of what is expected of firms, in particular because while optional, the requirement referenced transparency reporting. As a result, the ISQM 1 TF deliberated and identified two possible solutions, either:
- (a) Revising the requirement to require that transparency reports are prepared; or
  - (b) Only referring to transparency reports in the application material.<sup>9</sup>
75. In considering an appropriate way forward, the ISQM 1 TF noted several comments from respondents indicating that transparency reports are still evolving. The ISQM 1 TF undertook further targeted information gathering to understand:

<sup>9</sup> In paragraph 45 of ED-ISQM 1, a reference to in-process reviews was also described as a *possible* form of engagement inspections. In the revisions to proposed ISQM 1, this reference was removed, and in-process reviews have instead been described in application material.

- (a) The effectiveness and usefulness of transparency reports; and
- (b) How transparency reports have evolved over the last few years.

A summary of the information gathered is included in **Appendix 4**.

76. As a result of the information gathering, the ISQM 1 TF observed that:
- (a) While information in the form of a transparency report may affect investors' perception of quality, there is varied evidence of the extent to which transparency reports are being used by intended users.
  - (b) The nature of information that is being communicated, the granularity of the information and the tone and volume of the transparency reports varies across firms and jurisdictions, including when there are established requirements for transparency reports at a jurisdictional level. Furthermore, there has been an ongoing evolution in the information being communicated, and how it is presented.
77. The ISQM 1 TF notes that transparency reporting already exists in certain jurisdictions and is required for certain firms, however there are varying interpretations of, and views about, what a transparency report is and the information it should provide. The ISQM 1 TF is of the view that it is not the form of report that is important (i.e., a transparency report); instead, what is important is that the firm proactively communicates externally in a timely manner, in whatever form and manner is most appropriate, and the information that is communicated is appropriate and relevant in the circumstances.
78. The ISQM 1 TF is of the view that if proposed ISQM 1 were to be amended to require firms to prepare a transparency report, the standard would inappropriately focus on transparency reports as the only form or manner of effective communication, when other forms of communication may be better in the circumstances. Furthermore, if transparency reports were required, in order to support consistent implementation, the ISQM 1 TF believes that there would need to be a framework for how the report should be prepared.
79. The ISQM 1 TF concluded that it would not be appropriate for proposed ISQM 1 to require firms to prepare transparency reports and set out how they should be prepared. The ISQM 1 TF is of the view that a principles-based approach which focuses the firm on proactive and timely communication, whatever the form, is a more robust and responsive approach to firms' communication externally and facilitates further innovation in external communications. The ISQM 1 TF is of the view that that a reference to transparency reports in the application material as a form of communication is the appropriate approach.
80. The ISQM 1 TF recommends that if transparency reports continue to evolve and be embraced, and more consistency evolves globally in the form and content of these reports, further consideration could be given to the need for further research or guidance on this topic. However, in view of the timeline for the completion of the ISQM 1 project, and the current global disparity relating to transparency reports, it is likely premature to further explore this topic at this stage.

#### *Other Changes to Information and Communication*

81. Other revisions to the requirements and application material in this component include:



- (a) Refining the quality objectives and responses to address the perceived prescriptiveness of the standard. In doing so, aspects of the responses have been included in the quality objectives and the quality objectives have been reorganized and streamlined. Some specific aspects of the responses were moved to application material (such as paragraph 41(b) and 41(c)(iv)(b.) of ED-ISQM 1).
- (b) Removing or refining application material to reduce the length of the application material and relocating examples into boxes. In doing so, some revisions to drafting were necessary to convert certain explanations to examples.
- (c) Improving the clarification of 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. The application material includes aspects that were relocated from the requirement in paragraph 41(c)(iv) in ED-ISQM 1, and enhancements to include considerations such as customary business practice and to emphasize that regulators may set requirements for communication externally.

**Matters for IAASB Consideration**

- 21. Does the IAASB support the Task Force’s views that the requirement addressing communication externally should be principles-based to encourage proactive and timely communication, and therefore the reference to transparency reports should be in application material?
- 22. Does the IAASB support the other proposed changes to the information and communication component?

**B.12 Specified Responses**

Relevant Paragraphs in Agenda Item 4-A			
Requirements	Application Material	Definitions	Other
41A	A153A–A153G	N/a	N/a

- 82. Given the refinement of the quality objectives and responses across the components to address the perceived prescriptiveness of the standard, only five specified responses remain in proposed ISQM 1. The ISQM 1 TF is of the view that the revised approach has also improved scalability and robustness, because it is evident that firms have to design and implement appropriate responses for their SOQM. This also addresses concerns from some respondents about the need for more complex firms to scale up.
- 83. The ISQM 1 TF considered the IAASB’s preliminary comments about relocating all responses to a separate section “specified responses.” In working through the remainder of the draft standard, the ISQM 1 TF remains of the view that the responses should be in a separate section, since:
  - (a) Some of the responses are relevant to multiple components;
  - (b) The central location of the specified responses highlights that the specified responses are minimal, and that the firm needs to design and implement their own responses; and
  - (c) Locating the specified responses in the components could create confusion as to why certain components have responses, and others do not.

84. To retain the linkage of the specified responses with the quality objectives and quality risks, and to emphasize that the specified responses are not sufficient, revisions have been made to paragraphs 22F and 41A of **Agenda Item 4-A**.

85. All other changes to this section of the standard have been explained elsewhere in this issues paper.

**Matters for IAASB Consideration**

23. Does the IAASB support the location of specified responses in a separate section, and how it has been linked to the firm's risk assessment process?

**B.13 Network Requirements and Network Services**

Relevant Paragraphs in Agenda Item 4-A			
Requirements	Application Material	Definitions	Other
58–62	A192–A204	19(k), A13, A14	14

*Update on Outreach Activities*

86. As discussed with the Board in December 2019, concerns were raised by certain respondents that more robust actions, or requirements are needed at the network level, and the ISQM 1 TF has noted the PIOB's recommendation that networks be better addressed in proposed ISQM 1. In response to these concerns, in December 2019 the ISQM 1 TF proposed:

- (a) Enhancing the requirement in proposed ISQM 1 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 (see paragraph 61(a) of **Agenda Item 4-A**).
- (b) Soliciting information from the networks about:
  - (i) The extent to which networks have already initiated implementation activities.
  - (ii) How networks are planning on supporting network firms in implementing proposed ISQM 1.
  - (iii) Based on the implementation activities already undertaken, the expected impact on the network and on the relationship between the network and network firms.

The ISQM 1 TF suggested using the feedback from these outreach activities 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.

87. At the December 2019 IAASB meeting, the ISQM 1 TF Chair provided an overview of feedback from the networks on the above matters arising from the outreach undertaken at the time, which had focused on the largest six networks. Since then, the ISQM 1 TF has continued its outreach and solicited further input from a selection of other mid-sized networks. An overall summary of the feedback is included in **Appendix 5**.

88. The ISQM 1 TF Chair and IAASB Staff have held, or will be holding, further discussions with certain MG members<sup>10</sup> including the two members who had expressed concern on networks,<sup>11</sup> before the March 2020 Board meeting. Feedback from this outreach will be shared with the Board during the March 2020 discussion. Additional outreach is also planned with IFIAR<sup>12</sup> following the March 2020 Board discussion.
89. The information from this outreach will be considered by the ISQM 1 TF in the context of balancing competing and important objectives related to networks, i.e.:
- (a) Firms determining whether network requirements and network services need to be adapted or supplemented to be appropriate for use (i.e., the issue of undue reliance on networks); and
  - (b) Promoting consistency of quality across networks, which is achieved through promoting firms' use of network requirements and the network undertaking monitoring activities to determine that network requirements have been appropriately implemented across the network firm.

*Revisions to Network Requirements and Network Services*

90. The revisions to the network requirements and network services in **Agenda Item 4-A** include the following:
- (a) Paragraph 59(c) of the December 2019 draft has been subsumed into paragraph 59(b), to address the Board's feedback in December 2019. In considering the revisions to paragraphs 59(b) and 59(c), the ISQM 1 TF noted that, in effect, paragraph 58(b) requires the firm to determine that the network services are appropriate for use.
  - (b) Paragraph 61(a) has been adjusted to address concerns from the Board in December 2019 that it created a de facto requirement for the network. The ISQM 1 TF is of the view that this paragraph is important to encouraging networks to monitor network requirements, as doing so promotes consistency of quality across the network. Paragraph 61A of the December 2019 draft was also subsumed into paragraph 61(a) to clarify the connection of these two requirements.
  - (c) Paragraph 62 has been adjusted and clarified, given written comments provided by Board members in December 2019. The ISQM 1 TF is of the view that the revisions are more principles-based, better focused on the firm's responsibilities related to the deficiencies and more consistent with the monitoring and remediation component, including how the network's monitoring activities would impact the firm's monitoring and remediation.
  - (d) Paragraph A201 has been enhanced to explain how the information from the network may be shared by the firm with engagement teams, in particular those performing audits of group financial statements.

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<sup>10</sup> The International Organization of Securities Commissions (IOSCO), International Association of Insurance Supervisors (IAIS) and Basel Committee on Banking Supervision (BCBS)

<sup>11</sup> IAIS and BCBS

<sup>12</sup> International Forum of Independent Audit Regulators

**Matters for IAASB Consideration**

- 24. Is the IAASB of the view that the changes to network requirements and network services are responsive to the Board comments in December 2019?
- 25. Does the IAASB support the other proposed changes to networks?
- 26. During the plenary, the IAASB will be asked to share views on the feedback from the remaining outreach activities (feedback from the ISQM 1 TF Chair to be provided during the plenary session).

**B.14 Documentation**

Relevant Paragraphs in Agenda Item 4-A			
Requirements	Application Material	Definitions	Other
66–69	A211–A215	N/a	N/a

- 91. ED-ISQM 1 did not include any questions that specifically requested input on the documentation requirements in the standard. However, the ISQM 1 TF received various comments from respondents on this topic, which are summarized in **Appendix 2**.
- 92. The ISQM 1 TF is of the view that a principles-based approach to documentation is appropriate and consistent with other standards, such as ISA 230.<sup>13</sup> The ISQM 1 TF is concerned that adding further material to the standard would be contrary to the efforts that have been made to improve the scalability and prescriptiveness of the standard. Recognizing the suggestions from respondents to provide examples of how to execute documentation, the ISQM 1 TF will consider how further clarification can be provided in the supplementary support materials that will accompany proposed ISQM 1.
- 93. The ISQM 1 TF identified opportunities to enhance the emphasis in the standard on the need for professional judgment in determining appropriate documentation. Specifically, various revisions have been proposed to paragraph A212 of **Agenda Item 4-A** describing factors that may affect the firm’s judgments about the form, content and extent of documentation, including how often documentation is updated.
- 94. Lastly, the ISQM 1 TF recognizes many concerns raised about the firm’s documentation related to the identification and assessment of quality risks, the ISQM 1 TF has clarified paragraph A214 of **Agenda Item 4-A** to explain that the firm is not required to document every factor that was taken into account in identifying and assessing quality risks.
- 95. The remaining changes to documentation are to align with other revisions to the standard.

**Matter for IAASB Consideration**

- 27. Does the IAASB support the proposed revisions to documentation?

<sup>13</sup> ISA 230, *Audit Documentation*

**B.15 Definitions**

- 96. ED-ISQM 1 did not include any questions that specifically requested input on the definitions in the standard, and most definitions have been addressed through comments on the components. On exposure, comments related to other definitions were received, and have been summarized in **Appendix 2**.
- 97. The ISQM 1 TF noted the comments that the definition of SOQM is repetitive of the objective of the standard. The ISQM 1 TF is of the view that this definition is important because it is central to the standard and is likely to be used in other IAASB standards, therefore it has been retained in the proposed standard.

**B.16 Meaning of the Effective Date**

Relevant Paragraphs in Agenda Item 4-A			
Requirements	Application Material	Definitions	Other
17	N/a	N/a	N/a

- 98. In September 2019, the respondents’ comments regarding the effective date on the proposed quality management standards were presented to the Board (see [Agenda Item 5 of the September 2019 meeting](#)). In responding to the question, respondents raised questions about the meaning of the effective date in ED-ISQM 1, i.e., what specific elements of the standard need to be in place and operating in order to satisfy the requirement for the SOQM to be “established.” Respondents questioned, for example, whether firms are expected to have performed a periodic evaluation by the effective date, which would involve a full cycle of monitoring and remediation.
- 99. The ISQM 1 TF has identified two possible interpretations of “established”:
  - (a) The system is designed, implemented and is operating by the effective date, and the firm has monitored and evaluated the SOQM by this date.
  - (b) The system is designed and implemented by the effective date, i.e., the firm has established quality objectives, identified and assessed quality risks, and designed and implemented responses, and the effective date is the date at which operations begin. In this scenario, the firm is not expected to have performed monitoring activities or evaluated the SOQM by the effective date.
- 100. The ISQM 1 TF is of the view that the second option described in the paragraph above (i.e., option (b)) is appropriate, because under option (a):
  - (a) Firms would, in effect, need to design and implement their SOQM for a full cycle of operation ahead of the effective date, possibly at least a year before. The ISQM 1 TF believes it would be inappropriate for the standard to expect a full cycle of operation to occur before compliance is achieved, and this approach would be inconsistent with how effective dates are dealt with in the ISAs (i.e., in the ISAs, they are effective for periods “beginning” so that the operation of the ISA begins as of the effective date).
  - (b) It would not be possible for newly formed firms to comply with the requirements of proposed ISQM 1 in their first year of operation because it is not possible to monitor or evaluate the system until a full cycle of operation has taken place.

101. Although the Board's consideration of the appropriate effective date for the quality management standards will take place at the time the standards are finalized and approved by the Board, the ISQM 1 TF is of the view that the description and intended meaning of the effective date needs to be considered prior to finalizing the standard. Paragraph 17 of **Agenda Item 4-A** has been adjusted to reflect the ISQM 1 TF's proposals.

**Matter for IAASB Consideration**

28. Does the IAASB agree with the ISQM 1 TF's approach to the meaning of the effective date, including the proposed description of the effective date in paragraph 17 of **Agenda Item 4-A**?

**B.17 Title Change to "ISQM"**

102. Question 15 of ED-ISQM 1 asked whether the change in title to ISQM will create difficulties in adopting the standard at a jurisdictional level. The feedback from respondents is summarized in **Appendix 2**.
103. The ISQM 1 TF acknowledges some of the difficulties highlighted by respondents. However, the Task Force is of the view that a statement that acknowledges that jurisdictions may title it differently may alleviate these issues. The ISQM 1 TF proposes including such a statement in the Basis for Conclusions.

**Matter for IAASB Consideration**

29. Does the IAASB agree with retaining the title change to the standard, i.e., the use of "ISQM"?

## Appendix 1

### ISQM 1 TF Activities Including Coordination with Other IAASB Task Forces and Working Groups and Other Standard Setting Boards

1. The following sets out the activities of the ISQM 1 TF including coordination with other IAASB Task Forces and Working Groups and other standard setting Boards relating to the [quality management project](#).

#### Task Force Activities in Quarter 1 of 2020

2. In the 1<sup>st</sup> quarter of 2020, the ISQM 1 TF has met once in person and held three teleconferences.

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

##### *ISA 220 TF, ISQM 2<sup>14</sup> TF and ISA 600 TF*

3. In the 1<sup>st</sup> quarter of 2020, the Chair of the ISQM 1 TF, ISQM 2 TF and Staff met via teleconference to discuss the interrelationship of the factors related to quality risks and the firm's policies or procedures addressing the selection of engagements for engagement quality review. Staff were also actively engaged on this topic.
4. In the 1<sup>st</sup> quarter of 2020, Staff of the ISQM 1 TF and ISA 220 TF discussed matters of mutual interest, in particular, the concerns raised by the Board about the changes to the engagement performance component in proposed ISQM 1. Staff of the ISA 220 TF meeting also attended the in-person meeting for ISQM 1.
5. Since the December 2019 meeting, Staff of the ISQM 1 TF, ISA 220 TF and ISA 600 TF held one teleconference to discuss matters of mutual interest. Further engagement between the Staff of the ISQM 1 TF and ISA 600 TF has also been undertaken on content in proposed ISA 600 (Revised) relevant to proposed ISQM 1 (Revised).

##### *IESBA*

6. In the 1<sup>st</sup> quarter of 2020, the Chair of the ISQM 1 TF and IAASB Staff held a teleconference with three IESBA Members and IESBA Staff to discuss proposed ISQM 1. Furthermore, the three IESBA Members and Staff were requested to provide written input on the ISQM 1 TF's proposals relevant to ethics prior to finalizing the Board papers. As part of these discussions, the three IESBA Members and Staff were provided with
  - (a) The feedback from respondents on questions 5 and 8, including the related Nvivo reports.
  - (b) Drafts of aspects of **Agenda Item 4-A** related to ethical matters.

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<sup>14</sup> ISQM 2, *Engagement Quality Reviews*

## 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 5: Objective of the standard and reference to public interest in the standard.
  - (b) Question 8 and related sub-questions: Responsibility for independence and relevant ethical requirements and network independence.
  - (c) Question 9: Technology.
  - (d) Question 10: Communication with external parties.
  - (e) Question 14: Service providers.
  - (f) Question 15: Change in title to "ISQM".
  - (g) Other additional comments on the following areas of ED-ISQM 1 that were not related to a specific question.
    - (i) Definitions;
    - (ii) Relevant ethical requirements;
    - (iii) Acceptance and continuance;
    - (iv) Documentation; and
    - (v) Editorial comments.

#### *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.

**Objective of the Standard and Reference to Public Interest in the Standard**

NVivo Summary of Analysis of Question 5	Agenda item X-C.1
NVivo Report for Question 5	Agenda Item X-C.2

*Overview of Responses to Question 5: Do you support the objective of the standard, which includes the objective of the system of quality management? Furthermore, do you agree with how the standard explains the firm's role relating to the public interest and is it clear how achieving the objective of the standard relates to the firm's public interest role?*

Comments from MG Members

4. MG members commented variously on the objective of the standard and how the standard explains the firm's role relating to the public interest as follows:
- (a) A MG member indicated support for greater emphasis on the importance of the public interest in managing the quality of audits. Another MG member acknowledged the lack of a definition of public interest, although supported including the public interest in the standard and encouraged that it be more prominent in the standard. This respondent also suggested considering including references in the standard to the public interest framework to be developed by the Public Interest Oversight Board or the IFAC Policy Position 5.<sup>15</sup>
  - (b) One noted their support for the objective of the standard, emphasizing that consistent, high-quality audits are in the public interest. Another MG member indicated that the objective should refer to the public interest, recognizing that the firm should act in a manner consistent with its responsibility to the public interest, including considering the needs of investors and other users.
  - (c) In the context of the concept of "reasonable assurance", a MG member suggested that the standard should clarify that an acceptably low level of risk is determined in the public interest, having regard to the various stakeholders of the firm, in particular audit, securities and financial

<sup>15</sup> [IFAC Policy Position 5: A Definition of the Public Interest](#)

services regulators. Another MG member was of the view that the level of assurance should be higher than “reasonable assurance.”

#### Comments from Other Respondents

##### Objective of the standard

5. Respondents supported the objective of the standard, with many also indicating their support for including the objective of the system within paragraph 18 of ED-ISQM 1. Further comments and suggestions from respondents included:
  - (a) More explicitly referring to the public interest in the objective of the standard.
  - (b) Clarifying the meaning of “reasonable assurance.” The comments in this regard were closely linked with comments on question 12(e) of ED-ISQM 1 regarding what firm leadership is expected to evaluate.
  - (c) Concerns that the references to various objectives and the interrelationship of the objectives is confusing and unclear. Respondents commented that the explanation of the relationship of the objective of the firm and the objective of the SOQM was clear in the explanatory memorandum and therefore suggested including this explanation in the standard.
6. Respondents who disagreed with the objective mostly indicated that the objective should more directly refer to the public interest, or expressed the view that the objective is not outcome-based. However, there were respondents who supported how the standard addresses public interest, who explicitly noted that they do not support a reference to the public interest in the objective of the standard.

##### How the standard explains the firm’s role relating to the public interest

7. Respondents expressed varying views on how the standard explains the firm’s role relating to the public interest and whether the standard is clear about how achieving the objective of the standard relates to the firm’s public interest role.
8. Respondents who raised concern with how the standard addresses public interest or indicated that it is not clear, were mostly of the view that there is a very wide interpretation of public interest, and therefore a common understanding or definition is needed of what public interest means. There were also comments that:
  - (a) The standard is not clear that public interest is variable and depends on the nature of the engagement and entity for whom an engagement is performed.
  - (b) The standard could more clearly explain the link between the objective of the standard and public interest, or why the consistent performance of quality engagements serves the public interest.
  - (c) More could be done in the requirements of the standard to reflect the public interest.

## Responsibility for Independence and Relevant Ethical Requirements and Network Independence

NVivo Summary of Analysis of Question 8	Agenda item X-C.1
NVivo Report for Question 8	Agenda Item X-C.3

*Overview of Responses to Question 8 and related sub-questions: With respect to matters regarding relevant ethical requirements:*

- (a) *Should ED-ISQM 1 require firms to assign responsibility for relevant ethical requirements to an individual in the firm? If so, should the firm also be required to assign responsibility for compliance with independence requirements to an individual?*
- (b) *Does the standard appropriately address the responsibilities of the firm regarding the independence of other firms or persons within the network*

Comments from MG Members

9. MG members did not comment on the matters in question 8.

Comments from Other Respondents

Assigning responsibility for relevant ethical requirements

10. Respondents expressed mixed views about whether firms should be required to assign responsibility for relevant ethical requirements to an individual in the firm. Respondents in favor of this approach variously commented as follows:
- (a) This is already general practice.
  - (b) How firms may implement the requirement may vary (i.e., assigning responsibility to an individual or multiple individuals). There were suggestions to highlight the flexibility in the standard, for example, explaining that in the case of SMPs the responsibility may be assigned to the same individual with ultimate responsibility for the SOQM or that aspects of the role may be delegated to other individuals
  - (c) Ethics is the responsibility of each individual who is subject to the RER and is not only the responsibility of a single individual within the firm.
  - (d) The responsibility for RER should include independence.
11. Respondents not in favor of a requirement for the firm to assign responsibility for RER to an individual noted various reasons including:
- (a) Firms should be provided flexibility in determining their structure and assignment of responsibilities. It was suggested that the requirement is too prescriptive, not scalable, and could create implementation challenges for SMPs.
  - (b) The need for this role should be driven by the related assessed quality risks. It was suggested that for SMPs such a role may not be necessary, and the requirement would merely be a compliance exercise.
  - (c) RER is a broader topic than independence, and covers multiple aspects of the firm (e.g., resources). Therefore, assigning responsibility for compliance with RER to a single individual is not practical.

12. There were also varying suggestions that the responsibility for RER or independence should be dealt with in the Code.

Assigning responsibility for independence

13. Respondents did not comment as extensively on whether firms should also be required to assign responsibility for compliance with independence requirements to an individual. However, in comparison with the proposal on assigning responsibility for relevant ethical requirements, respondents appeared more supportive of assigning responsibility for independence.<sup>16</sup>
14. Respondents who disagreed with the proposal for a requirement to assign responsibility for independence to an individual cited similar reasons as those outlined in paragraph 8 above.

The responsibilities of the firm regarding the independence of other firms or persons within the network

15. The majority of respondents were of the view that ED-ISQM 1 appropriately addresses the responsibilities of the firm regarding the independence of other firms or persons within the network. Respondents who disagreed noted that ED-ISQM 1 suggested that relevant ethical requirements are not relevant to others outside the firm, however in the circumstances of a group audit the component auditor is subject to the RER that are applicable to the group audit.

**Technology**

NVivo Summary of Analysis of Question 9	Agenda item X-C.1
NVivo Report for Question 9	Agenda Item X-C.4

*Overview of Responses to Question 9: Has ED-ISQM 1 been appropriately modernized to address the use of technology by firms in the system of quality management?*

Comments from MG Members

16. A MG member indicated support for expanding the resources section to include technology. However, this respondent suggested further addressing the use of technology at the firm and engagement level, such as the need for the firm to set clear expectations for how tools are to be used and the related responsibilities of engagement partners in this regard, and the firm having proper processes and controls to manage use of technology and to upskill auditors on technology.

Comments from Other Respondents

17. Respondents indicated support for how the standard has been modernized to address the use of technology, with some respondents emphasizing that the manner in which these requirements have been developed is principles-based, thereby providing sufficient flexibility for firms of varying size and complexity, and catering for changes in technology in the future. However, respondents commented further as follows:

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<sup>16</sup> For example, 7 respondents agreed with assigning responsibility for independence, but disagreed with the proposal to assign responsibility for relevant ethical requirements, whereas only 2 respondents agreed with assigning responsibility for RER but disagreed with the proposal to assign responsibility for independence.

- (a) There is a need to clarify the scope of technology contemplated by the standard. Some respondents suggested clarifying that the standard applies to technology that is designed to enable the operation of the SOQM and the performance of engagements.
  - (b) Additional guidance would be useful, in particular for SMPs.
  - (c) Various specific comments were made about aspects of the application material.
18. Respondents who did not support how technology has been addressed in ED-ISQM 1 mostly indicated that it should be more robust and extensive in addressing quality risks arising from technology. A few respondents who supported how the standard addresses technology had also suggested that more could be done to address technology.

*Other Comments on Resources*

Comments from MG Members

19. A MG member indicated that ED-ISQM 1 should include explicit requirements to address how delivery centers are managed by the firm and the responsibilities of engagement partners and teams when using work performed by delivery centers.

Comments from Other Respondents

20. Respondents provided various editorial suggestions and suggestions on the application material, and also encouraged more explicit guidance on audit delivery models in the application material. There were also varying ad-hoc comments on the aspects of this component dealing with human resources.

**Communication with External Parties**

NVivo Summary of Analysis of Question 10	Agenda item X-C.1
NVivo Report for Question 10	Agenda Item X-C.5

*Overview of Responses to Question 10: Do the requirements for communication with external parties promote the exchange of valuable and insightful information about the firm's system of quality management with the firm's stakeholders? In particular, will the proposals encourage firms to communicate, via a transparency report or otherwise, when it is appropriate to do so?*

Comments from MG Members

21. One MG member indicated that additional requirements to transparency disclosures would enhance the enforceability of a principal-based implementation of ED-ISQM 1.

Comments from Other Respondents

22. Respondents broadly agreed that the proposed requirements in ED-ISQM 1 would promote the exchange of valuable and insightful information about the firm's SOQM with the firm's stakeholders, and encourage communication externally as appropriate. However, respondents had varying comments on the reference to "transparency reports" in the requirement in ED-ISQM 1 as follows:
- (a) There were respondents who, in supporting the proposals, emphasized that it would be inappropriate to require firms to prepare a transparency report.

- (b) Respondents who raised concern with the reference to “transparency report” in the requirement, cautioned that it may be interpreted that a transparency report is required, or that it may become a “de facto” requirement. Furthermore, respondents noted that other methods of communication may be appropriate, and that preparing a transparency report may not be appropriate for all firms. Respondents recommended that the reference to transparency reports rather be located in application material.
  - (c) Other respondents, including one investor, indicated that the standard should be more robust in addressing transparency reports, with respondents variously suggesting that the standard require transparency reports for certain firms or all firms. Another respondent who was an investor encouraged the IAASB to make an explicit reference to the importance of investor engagement.
23. Respondents who did not agree with the proposals in the standard highlighted various reasons, including the following:
- (a) Similar to concerns highlighted above, the requirement is too prescriptive in referring to transparency reports.
  - (b) The standard should only address communication externally to the extent that it is required by law or regulation.
  - (c) The requirement to communicate externally is, or should be, addressed at a jurisdictional level.
  - (d) Communication externally is an output of the SOQM, rather than something that supports managing and achieving quality on engagements.
24. Respondents also variously suggested that the standard:
- (a) Further clarify the external parties with whom the firm may communicate, with a suggestion from an investor that the standard should specifically address prospective shareholders and creditors.
  - (b) Address the content of the report or how it should be prepared, or define what is a transparency report; and
  - (c) Address audit quality indicators.

**Other Comments on Information and Communication**

25. Concern was raised that the term “information system” implies that a complex and formal infrastructure is required, thereby causing scalability challenges. Respondents suggested including application material or examples to assist with implementation.

**Service Providers**

NVivo Summary of Analysis of Question 14	Agenda item X-C.1
NVivo Report for Question 14	Agenda Item X-C.6

*Overview of Responses to Question 14: Do you support the proposals addressing service providers?*

**Comments from MG Members**

26. MG members did not comment on this aspect of ED-ISQM 1.

Comments from Other Respondents

27. Respondents supported addressing service providers in ED-ISQM 1, however recommended clarifying the scope of service providers covered by the provisions in ED-ISQM 1. Respondents suggested that the scope should not be too onerous and questioned whether services, such as “off the shelf packages” or services that are only indirectly related to the SOQM, should be included.
28. Respondents who supported the proposals also raised concern about challenges in obtaining the appropriate information from the service providers, particularly relating to intellectual and technological resources. Respondents explained, for example, that service providers may be unwilling to provide information about the procedures undertaken in designing, implementing, and operating the resources, as it may reveal “trade secrets.”
29. Respondents requested that additional guidance or clarity is provided about how the requirements should be implemented, including addressing what firms should do in the event that they are unable to obtain the appropriate information from the service provider and demonstrating how the implementation of the requirements may be scaled according to the nature of the service or service provider.
30. Respondents who did not support the proposals indicated that they are too onerous, particularly regarding obtaining the appropriate information from the service provider and evaluating their services, given the expertise of the firm.

**Change in Title to “ISQM”**

NVivo Summary of Analysis of Question 15	Agenda item X-C.1
NVivo Report for Question 15	Agenda Item X-C.7

*Overview of Responses to Question 15: With respect to national standard setters and regulators, will the change in title to “ISQM” create significant difficulties in adopting the standard at a jurisdictional level?*

Comments from MG Members

31. One MG member indicated support for the title change to “ISQM.”

Comments from Other Respondents

32. Other respondents broadly indicated no concern over the adoption of the standard because of the proposed change in the title of the standard.
33. Respondents who raised concern with changing the title of the standard cautioned that jurisdictional legislation may make reference to the extant title and that the change could pose an additional administrative burden on jurisdictions in adopting the standard.

**Other Additional Comments Not Specific to a Question**

NVivo Summary of Analysis of other additional comments	Agenda item X-C.1
NVivo Report for other additional comments	Agenda Item X-C.8

*Definitions (Paragraph 19 of ED-ISQM 1)*

34. Respondents' comments on definitions that are related to specific components were included with summary of feedback on those components (e.g., the deficiency definition was included with monitoring and remediation).
35. Other comments from respondents on definitions included:
  - (a) Concerns about the definition of engagement team, which have been shared with the ISA 220 TF.
  - (b) Observations that the definition of SOQM is repetitive of the objective of the standard.

*Relevant Ethical Requirements (Paragraphs 19(s), 32 and 33 of ED-ISQM 1)*

36. Respondents who provided comments on relevant ethical requirements mostly provided editorial suggestions.

*Acceptance and Continuance (Paragraphs 34–35 of ED-ISQM 1)*

37. Ad-hoc comments from respondents regarding the acceptance and continuance component mostly related to a perceived lack of clarity on the meaning of the integrity and ethical values of the client, and how this would be measured.

*Documentation (Paragraphs 66–69 of ED-ISQM 1)*

38. Various comments were raised by respondents across the questions in ED-ISQM 1 that were related to documentation.
39. A MG member expressed the view that the standard should require policies and procedures to be in written format, and the firm to document actions and decisions arising from changes in the nature and circumstances of the firm or its engagements, actions and decisions in response to differences of opinion, and the assessment of the exercise of professional skepticism.
40. Respondents across all other stakeholder groups raised concern that the documentation expectations in the standard are not sufficiently clear, and there were multiple comments that this was particularly vague in relation to the identification of quality risks. Respondents also highlighted concerns about the standard creating onerous or excessive documentation, particularly given the lack of clarity of documentation expectations. Respondents variously suggested clarifying the documentation expectations in the standard or developing additional guidance to demonstrate how a firm should document its SOQM.
41. There were also suggestions from three regulators and audit oversight bodies that firms should be expected to document why a requirement in ED-ISQM 1 is not relevant.

*Editorial comments*

42. Editorial comments from respondents were allocated in Nvivo to the specific components, however a few ad-hoc comments were unallocated. Furthermore, a respondent provided editorial comments on the conforming amendments.



**Appendix 3**

**How the Proposals Address the Key Areas of Concern**

	Scalability	Tailoring	Complexity	Prescriptiveness	Applicability
(a) Restructuring the sequence of the components (firm’s risk assessment process moved before governance and leadership) and reducing the length of the introduction.			X		
(b) Explicitly describing the firm’s risk assessment process and monitoring and remediation as processes.			X		
(c) 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.	X	X	X	X	X
(d) Simplifying the process for identifying and assessing quality risks and relocating the threshold for identifying quality risks to the definition of quality risks.			X	X	
(e) Introducing factors focused on the nature and circumstances of the firm and the nature and circumstances of the engagements performed by the firm in identifying and assessing quality risks.	X	X			X
(f) Refining the quality objectives and responses in the components, including moving detailed aspects of the requirements to application material.			X	X	X
(g) Relocating all responses to a separate section “specified responses”. It is noted that this emphasizes that the responses in the standard alone will not be sufficient to achieve the objectives of the SOQM.	X	X	X	X	X
(h) Enhancing the risk-based approach in monitoring and remediation.	X	X			
(i) Refocusing the requirement for engagement inspections on the effect of other monitoring activities on the selection of engagements for inspection, the appropriate combination of selecting engagements and engagement partners and risk.	X	X	X	X	X

	Scalability	Tailoring	Complexity	Prescriptiveness	Applicability
(j) 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.			X		
(k) Revising paragraph 22 of <b>Agenda Item 4-A</b> to deemphasize the focus on compliance.	X	X		X	X
(l) Removing the reference to the firm's risk assessment process in paragraph 59 of ED-ISQM 1.			X		
(m) Signposting scalability examples in the application material, and presenting examples in the application material in boxes and tables.	X	X	X		X
(n) Within the examples in the application material, including examples that address less complex and more complex firms to demonstrate the “scaling-up” and the “scaling-down”.	X	X			X
(o) Moving some of the application material and the appendix to guidance outside of the standard.			X	X	
(p) Removing duplicative material, or material that was viewed as unhelpful, unnecessary or superfluous.			X	X	

## Transparency Reports – Further Information Gathering

1. In formulating an appropriate way forward regarding transparency reports, the ISQM 1 TF determined that it would be helpful to further understand:
  - (a) The effectiveness and usefulness of transparency reports; and
  - (b) Whether transparency reports have evolved over the last few years.

### *Effectiveness and Usefulness of transparency reports*

2. The ISQM 1 TF noted the recent thematic review issued by the UK Financial Reporting Council (FRC) on transparency reports,<sup>17</sup> issued in September 2019. Transparency reports have been required since 2016, in accordance with the EU Audit directive, Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014, Article 13: Transparency Report.. In summary, the review revealed that transparency reports prepared by firms are not currently effective as a result of:
  - (a) A lack of awareness amongst investors and audit committee chairs that transparency reports exist; and
  - (b) In the case of those who are aware of its existence, transparency reports being perceived as too long, and overly positive.
3. The FRC thematic review suggests a variety of actions to address the effectiveness of transparency reports, including the role that firms, the FRC and users can each play. However, the thematic review concludes that the requirements dealing with transparency reports in the UK need to be rethought.
4. The ISQM 1 TF also noted a survey undertaken by the CFA Institute<sup>18</sup> which found that insightful communication to investors is the topmost factor influencing the *perceived* value of audit. The survey highlighted the communications considered most influential by investors, in the following order of ranking:
  - (a) The quality of information contained within the auditor's report.
  - (b) Disclosures to investors of the audit quality indicators that are monitored by audit committees and/or regulators.
  - (c) Audit firms' communication to investors (e.g., published audit firm transparency reports).
5. The ISQM 1 TF considered issuing a survey to investor groups to further understand the demand for transparency reports. However, the ISQM 1 TF concluded that a survey of this nature would inevitably prompt a positive result, as investors undeniably appreciate having more information at their disposal, whether it is actually used or not. Furthermore, the ISQM 1 TF is of the view that there are different interpretations of what constitutes a transparency report, and in order to fully appreciate and understand the information needs of users, a more thorough survey and research would need to be undertaken.

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<sup>17</sup> [Transparency Reporting, AQR Thematic Review, September 2019](#)

<sup>18</sup> CFA Institute Member Survey Report, Audit Value, Quality and Priorities, issued in 2018

*Whether Transparency Reports Have Evolved Over the Last Few Years*

6. IAASB Staff performed a desktop analysis of a selection of transparency reports published between 2010 to 2019 across various jurisdictions to observe how transparency reports have evolved.<sup>19</sup> It was noted that:
- (a) There are common topics communicated in the transparency reports across the firms, however the level of detail provided varies amongst firms. For example, in describing external monitoring that had been undertaken by audit oversight authorities, some firms linked readers to their public regulatory reports and provided commentary on their performance year over year, while others only described the external monitoring process.
  - (b) The amount of commentary provided, even within a firm has changed over time. For example, in 2010, a firm's transparency report included one paragraph on its independence process, and by 2019 the same information had expanded to two pages.
  - (c) New information has been added into transparency reports over time. For example, in more recent transparency reports firms added details surrounding their initiatives over technology and data analytics, as well as their people initiatives such as mental health awareness, inclusion and diversity campaigns.

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<sup>19</sup> In performing the analysis, IAASB staff reviewed transparency reports across the largest five accounting firms. IAASB staff reviewed both regional transparency reports and global transparency reports. The analysis consisted of comparing one particular firm's report over time (e.g., a firm's transparency report from 2010 to 2019), as well as comparing reports across firms.

## Appendix 5

### **Networks Outreach – Overview of Feedback from the Networks About the Effect of Proposed ISQM 1 at the Network Level**

As highlighted in the body of the issues paper, the ISQM 1 TF undertook outreach with ten networks, to understand the impact that proposed ISQM 1 is likely to have at the network level. The feedback is summarized below.

1. Most of the networks are already planning for the implementation of proposed ISQM 1 and are actively encouraging member firms to commence preparation for the standard. The activities being undertaken include forming project teams, documenting processes and undertaking engagement across the network firms and with their leadership to build awareness of the changes. The networks also highlighted the importance of awareness-building with other business practices of the networks. However, some networks noted challenges in certain regions whereby the network firms are lacking an understanding of what will be expected, i.e., that the SOQM will need to be tailored and will not be provided by the network or a service provider.
2. Participants observed that the standard is creating multiple opportunities, such as:
  - (a) Firm wide buy-in to the importance of the SOQM, in particular given the increased responsibilities of firm leadership.
  - (b) Re-evaluation of current activities and how these can be improved, including to drive commonality across the network.
  - (c) Increased emphasis and recognition that each firm is responsible for their SOQM and the network's role is to support the firm.
3. Participants shared feedback regarding the impact, or expected impact, at the network level, including:
  - (a) The need for enhanced resources at the network level, which are often sourced from member firms, to support implementation and maintenance.
  - (b) A strong focus on how the network requirements and services are documented and shared with the network firms, so that appropriate information is consistently provided to the network firms.
  - (c) Improved two-way communication and the need for the network to be more agile and nimble in responding to information provided by the network firms. It was further noted that collating information from the network firms is a challenge, and networks are considering mechanisms to facilitate the communication, such as technology solutions.
  - (d) A need to consider how network requirements and services will be monitored. For example, one network suggested that although a portion will be monitored through engagements, monitoring activities will need to be established at the network level, similar to the work that would be undertaken by an internal audit function. Some networks also considered whether, and if so what, assurance or reporting the network will need to provide to network firms.
4. Participants indicated varying approaches of how the network plans to approach implementation and involve network firms. For example:

- (a) Some networks indicated that they are currently looking for good practices in network firms that can be globalized. Similarly, some suggested they are considering how the network can facilitate knowledge sharing between network firms.
  - (b) There appear to be a variety of approaches being contemplated by the networks in terms of the extent to which the network may set common quality objectives, quality risks and responses. It was noted that there are varying types of networks, and that networks are not established in the same way or provide the same network requirements or network services. It was also noted that for some of the “non-big 6” networks, the network requirements are less prescriptive, although it was noted that this may evolve with the new standard. Nevertheless, there was consensus that, irrespective of what the network provides, member firms will be expected to supplement what they receive to tailor for their circumstances.
5. When asked what actions the IAASB could take that would have the effect of promoting consistency of quality across a network, it was suggested that a clear and succinct standard would be essential to consistent application across network.

## Appendix 6

### Tracking List of Questions and Topics from ED-ISQM 1

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.

Question	IAASB discussion
Question 1 and related sub-questions	September 2019
Question 2	September 2019
Question 3	December 2019
Question 4	September 2019
Question 5 and related sub-questions	March 2020
Question 6 and related sub-questions	September 2019
Question 7	December 2019
Question 8 and related sub-questions	March 2020
Question 9	March 2020
Question 10	March 2020
Question 12 and related sub-questions	December 2019
Question 13	December 2019
Question 14	March 2020
Question 15	March 2020
Additional Comments (Part 1) <ul style="list-style-type: none"> <li>• Introduction</li> <li>• General requirements</li> <li>• The firm's risk assessment process (additional comments)</li> <li>• Engagement performance</li> <li>• Appendix</li> </ul>	December 2019
Additional Comments (Part 2) <ul style="list-style-type: none"> <li>• Definitions</li> <li>• Relevant ethical requirements</li> <li>• Acceptance and continuance</li> <li>• Documentation</li> <li>• Editorial comments</li> </ul>	March 2020
Support material	June 2020

**List of Respondents to ED-ISQM 1**

	<b>Respondent</b>	<b>Region</b>
<b>Monitoring Group</b>		<b>Total: 4</b>
1	Basel Committee on Banking Supervision	Global
2	International Association of Insurance Supervisors	Global
3	International Forum of Independent Audit Regulators	Global
4	International Organization of Securities Commissions	Global
<b>Investors and Analysts</b>		<b>Total: 2</b>
5	Corporate Reporting Users' Forum	Global
6	International Corporate Governance Network	Global
<b>Regulators and Audit Oversight Authorities</b>		<b>Total: 6</b>
7	Canadian Public Accountability Board	North America
8	Committee of European Audit Oversight Bodies	Europe
9	Financial Reporting Council United Kingdom	Europe
10	Independent Regulatory Board for Auditors	Middle East and Africa
11	Irish Auditing and Accounting Supervisory Authority	Europe
12	National Association of State Boards of Accountancy	North America
<b>National Auditing Standard Setters</b>		<b>Total: 13</b>
13	AICPA	North America
14	Australian Auditing and Assurance Standards Board	Asia Pacific
15	Canadian Auditing and Assurance Standards Board	North America
16	Chinese Institute of Certified Public Accountants	Asia Pacific
17	Compagnie Nationale des Commissaires aux Comptes and the Conseil Supérieur de l'Ordre des Experts-Comptables	Europe
18	Conselho Federal de Contabilidade - Federal Accounting Council	South America
19	Hong Kong Institute of Certified Public Accountants	Asia Pacific
20	Institut Der Wirtschaftsprüfer	Europe
21	Japanese Institute of CPAs	Asia Pacific
22	Kammer der Steuerberater und Wirtschaftsprüfer	Europe
23	Malaysian Institute of Accountants - Auditing and Assurance Standards Board	Asia Pacific
24	New Zealand Auditing and Assurance Standards Board	Asia Pacific
25	Royal Nederlandse Beroepsorganisatie van Accountants	Europe



Proposed ISQM 1: Issues and Recommendations  
IAASB Main Agenda (March 2020)

	<b>Respondent</b>	<b>Region</b>
<b>Accounting Firms</b>		<b>Total: 25</b>
26	Baker Tilly International	Global
27	Baker Tilly Virchow Krause LLP	North America
28	BDO International	Global
29	CAS International	Asia Pacific
30	Crowe Global	Global
31	Deloitte Touche Tohmatsu Limited	Global
32	Duncan and Topliss	Europe
33	ETY Global	Middle East and Africa
34	EY Global Limited	Global
35	Grant Thornton International Limited	Global
36	Haysmacintyre LLP	Europe
37	KPMG IFRG Limited	Global
38	Kreston International	Global
39	Mazars	Global
40	Mazars USA LLP	North America
41	MGI Worldwide	Global
42	MNP LLP	North America
43	Moore Stephens International	Global
44	Nexia International	Global
45	Nexia Smith & Williamson	Europe
46	PKF International Limited	Global
47	PKF South Africa	Middle East and Africa
48	PriceWaterhouseCoopers	Global
49	RSM	Global
50	SRA	Europe
<b>Public Sector Organizations</b>		<b>Total: 10</b>
51	Auditor General South Africa	Middle East and Africa
52	Australasian Council of Auditors General	Asia Pacific
53	International Organization of Supreme Audit Institutions	Global
54	National Audit Office of Malta	Europe
55	Office of the Auditor General New Zealand	Asia Pacific
56	Office of the Auditor General of Alberta	North America
57	Office of the Auditor General of Canada	North America

	<b>Respondent</b>	<b>Region</b>
58	Provincial Auditor Saskatchewan	North America
59	Swedish National Audit Office	Europe
60	US Government Accountability Office	North America
<b>Member Bodies and Other Professional Organizations</b>		<b>Total: 36</b>
61	Accountancy Europe	Europe
62	Australian Accounting Professional and Ethics Standards Board	Asia Pacific
63	Belgian Institute of Registered Auditors	Europe
64	CA Ireland	Europe
65	California Society of CPA's	North America
66	Center for Audit Quality	North America
67	Chartered Accountants Australian and New Zealand and ACCA	Global
68	Comision Interamericana de Control de Calidad de la AIC	South America
69	Comite Control de Calidad del ICPARD	South America
70	Consiglio Nazionale dei Dottori Commercialisti e degli Esperti Contabili	Europe
71	CPA Australia	Asia Pacific
72	European Federation of Accountants and Auditors for SMEs	Europe
73	EXPERTsuisse	Europe
74	FAR (Institute for Accounting Profession in Sweden)	Europe
75	FSR - Danish Auditors	Europe
76	IFAC Small and Medium Practices Committee	Global
77	Illinois CPA Society	North America
78	Institut des Experts-Comptables et des Conseils Fiscaux – Instituut Van de Accountants en de Belastingconsulenten	Europe
79	Institute of Chartered Accountants in England and Wales	Europe
80	Institute of Chartered Accountants of Pakistan	Asia Pacific
81	Institute of Chartered Accountants of Scotland	Europe
82	Institute of Chartered Accountants of Sri Lanka	Asia Pacific
83	Institute of CPAs of Uganda	Middle East and Africa
84	Institute of Independent Auditors of Brazil	South America
85	Institute of Singapore Chartered Accountants	Asia Pacific
86	Instituto de Censores Jurados de Cuentas de España	Europe
87	Instituto Mexicano de Contadores Públicos	North America
88	Korean Institute of CPAs	Asia Pacific

Proposed ISQM 1: Issues and Recommendations  
IAASB Main Agenda (March 2020)

	<b>Respondent</b>	<b>Region</b>
89	Malaysian Institute of CPAs	Asia Pacific
90	New York State Society of Certified Public Accountants	North America
91	Nordic Federation of Public Accountants	Europe
92	Royal Institute of Chartered Surveyors	Global
93	Self-Regulatory Organization of Auditors Association	Europe
94	South African Institute of Chartered Accountants	Middle East and Africa
95	The Finnish Association of Authorised Public Accountants	Europe
96	Wirtschaftsprüferkammer	Europe
<b>Academics</b>		<b>Total: 1</b>
97	UNSW Audit Research Network	Asia Pacific
<b>Individuals and Others</b>		<b>Total: 3</b>
98	Shady Fouad Ahmed Mehelba	Middle East and Africa
99	Training and Advisory Services and Chartered Accountants Academy	Middle East and Africa
100	Vera Massarygina	Europe

## Draft Minutes of the December 2019 IAASB Discussion

### 1. Proposed ISQM 1<sup>20</sup>

Ms. French outlined respondents' feedback on specific areas of the Exposure Draft of ISQM 1 (ED-ISQM 1), and emphasized that the ISQM 1 TF has continued to focus on the following key issues highlighted by respondents:

- The scalability of the standard and firms appropriately tailoring the system of quality management (SOQM) for their circumstances;
- The complexity and prescriptiveness of the requirements; and
- Developing a standard that can be applied in all circumstances.

Ms. French explained the ISQM 1 TF proposals to address the focus areas, as well as respondents' comments on the specific areas presented to the Board.

#### THE STRUCTURE OF PROPOSED ISQM 1

The IAASB supported:

- Moving the firm's risk assessment process before governance and leadership;
- Including essential application material in the section "System of Quality Management" to highlight the importance of governance and leadership.
- Locating the requirements dealing with the responsibilities of firm leadership in the section "System of Quality Management," although the Board noted that it adds more complexity because it is also a response in the "governance and leadership" component.
- Relocating the requirements dealing with the evaluation of the SOQM by firm leadership to a separate section.

However, the IAASB expressed mixed views about relocating all responses to a separate section "specified responses," with certain Board members noting that this approach creates a disconnect with the quality objectives. Recognizing that not all components have yet been considered, the IAASB encouraged the ISQM 1 TF to further explore the appropriate location of the responses and include an introduction to the specified responses that explains why they are important and included in the standard.

#### THE FIRM'S RISK ASSESSMENT PROCESS

The IAASB supported the principle of introducing quality risk considerations, noting that it improves the scalability of the standard. However, the IAASB provided further comments as follows:

- The relationship between the quality risk considerations, understanding the conditions, events, circumstances, actions or inactions that may adversely affect the achievement of the firm's quality objectives, and identifying and assessing the quality risks needs to be clarified. This includes

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<sup>20</sup> Proposed International Standard on Quality Management (ISQM) 1 (Previously International Standard on Quality Control 1), *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*

considering whether the term “quality risk considerations” is the most appropriate term to use in the context of this relationship, and whether the definition of the term is needed.

- The completeness of the quality risk considerations or how to present them may need to be considered, as firms may incorrectly interpret that the quality risk considerations are complete.
- Additional quality risk considerations that may need to be considered include the design and operating characteristics of the firm, the firm’s reputation, changes in the firm, commercial considerations, the financial position of the firm and the firm’s IT resources.
- The description of the nature and circumstances of engagements performed by the firm and the related application material needs to be refined, since the manner in which they are described covers all engagements and is open-ended. The Board also raised concern with the reference to “the expectations of stakeholders” in paragraph 22E(b)(ii)b. of **Agenda Item 7-A**.

The IAASB was generally of the view that the examples of quality risk considerations (paragraphs A24R, A35A, A112A and A159A of **Agenda Item 7-A**) should be located in guidance separate from the standard. The IAASB emphasized that guidance will need to be available within a reasonable period following the finalization of the standard.

With respect to the proposed changes to paragraphs 22G and 22H of **Agenda Item 7-A**, the IAASB was generally supportive, although encouraged the ISQM 1 TF to consider:

- Further refining these paragraphs.
- Clarifying what is intended by modifying the quality objectives, given the robustness of the quality objectives in the standard.

With respect to the definitions related to the firm’s risk assessment process, the IAASB suggested adding likelihood or probability to the definition of quality risks.

#### THE APPROACH TO QUALITY OBJECTIVES AND RESPONSES IN THE COMPONENTS

The IAASB in general supported how the quality objectives and responses have been adjusted and refined, as demonstrated in the governance and leadership component and engagement performance component. The IAASB further suggested that:

- Some of the quality objectives appear to be responses and need to be written in more of an outcome-based manner.
- In the basis for conclusions, it is explained how the revised approach is as rigorous as extant ISQC 1.

#### MONITORING AND REMEDIATION

The IAASB broadly agreed with the approach on how to embed risk in the monitoring activities (i.e., through directly stating the quality risk for monitoring activities) and generally supported the proposed quality risk for monitoring. However, the IAASB provided further additional comments as follows:

- The description of the quality risk for monitoring should be more proactive and preventative, as it currently appears backward-focused.
- The component has extensive requirements giving rise to continuing concerns about the scalability of this component.

- The link between monitoring and remediation and the evaluation of the SOQM needs to be clearer.

The IAASB also supported the requirements for engagement inspections, however expressed mixed views regarding the proposed removal of the reference to a three year cycle in the application material. Further comments provided by the IAASB on this aspect of the standard included:

- Removing the reference to “completed engagements” in the first sentence of paragraph 45 of **Agenda Item 7-A**).
- More explicitly referring to the selection of engagement partners based on risk in paragraph 45(b) of **Agenda Item 7-A**.
- A suggestion to further explain in the application material how in-process engagement inspections may affect the selection of completed engagements for inspection.

The IAASB supported the definitions of “deficiency” and “finding,” and the improvements to the framework for evaluating findings and identifying deficiencies, and further suggested:

- Removing the last part of the definition of finding (i.e., the reference to “which indicates that one or more deficiencies may exist”).
- Explaining in the application material that a firm’s SOQM may still be effective, despite having deficiencies.
- Exploring whether further clarification could be provided of how the firm determines that findings are deficiencies.

#### EVALUATION OF THE SOQM

The IAASB agreed with the intended purpose of the evaluation of the SOQM. The IAASB suggested that the evaluation of the SOQM should determine whether, at a point in time:

- Any identified deficiencies have been remediated, are in the process of being remediated or plans are in place to remediate the deficiency; and
- The effect of identified deficiencies have been appropriately corrected.

#### NETWORKS

The IAASB concurred with the ISQM 1 TF’s approach to address concerns raised by certain respondents about networks.

With respect to the changes in proposed ISQM 1 dealing with network requirements and network services, the IAASB variously:

- Questioned the need for different requirements for network requirements versus network services in paragraphs 59(b) and 59(c) of **Agenda Item 7-A**.
- Raised concern that paragraph 61(a) of **Agenda Item 7-A** creates a de facto requirement for the network.
- Highlighted the need for clarity on documentation expectations for the understanding of network requirements and network services.

## OTHER MATTERS

The IAASB was generally supportive of the other areas of the standard presented in **Agenda Item 7-A**, including governance and leadership, engagement performance and other revisions to the introduction, appendix and application material that aimed to simplify the standard. Further comments provided by the IAASB included:

- In relation to the introduction, reinstating some of the explanations about the firm's risk assessment process in paragraph 10 of ED-ISQM 1.
- In relation to culture, the IAASB suggested rephrasing this to "the firm commits and promotes a culture of quality."
- In relation to leadership, the IAASB recommended placing more emphasis on leadership promoting a culture through behavior.
- In relation to engagement performance, the IAASB emphasized the impact of changes in this component on proposed ISA 220 (Revised) and ISA 600, and suggested reconsidering whether it is appropriate to relocate aspects of the requirements from ED-ISQM 1 to application material.

## IAASB CAG CHAIR'S REMARKS

Mr. Dalkin highlighted that when the CAG discussed the inspection of completed engagements in leading up to ED-ISQM 1, the CAG was supportive of including the reference to a three year cycle in the application material. Mr. Dalkin also emphasized the CAG's keen interest in networks.

## PIOB OBSERVER REMARKS

Mr. van Hulle indicated support for the quality risk considerations and including the examples of quality risk considerations in the standard. Mr. van Hulle encouraged the ISQM 1 TF to consider:

- How the quality risk considerations interact with other aspects of the standard and affect the firm's system of quality management in practice.
- Clarifying how the requirements addressing network requirements and network services are related to the quality risk considerations.
- Including the firm's business model as a quality risk consideration, including the combination of audit and non-audit services offered by the firm. In this regard, Mr. van Hulle urged the ISQM 1 TF to explain how the firm's business model may give rise to quality risks and may impact audit quality, such as through incentive structures and resource allocation across the firm.

Mr. van Hulle also indicated his support for the manner in which networks are being addressed, including undertaking additional outreach, and noted that the ISQM 1 TF has been responsive to the concerns. He added that networks are structured differently and therefore cannot be treated in a similar manner, however when networks attest to having consistent quality, this needs to be demonstrated.

Mr. van Hulle also recommended that the reference to the culture of the firm indicate that "the firm commits to a culture of quality."

#### WAY FORWARD

The ISQM 1 TF will consider the matters raised by the IAASB and will present a full draft of proposed ISQM 1 to the IAASB in March 2020. This will include proposals to address comments from respondents that have not yet been presented to the IAASB.