

Proposed ISQM 1:¹ Analysis of Due Process Related to Re-Exposure

Overview

1. If the Board votes to approve proposed ISQM 1, then a separate affirmative vote of the Board is required on whether the ISQM should be re-exposed. Based on the proposals in **Agenda Item 2-A**, and prior to any changes proposed at the September 2020 IAASB meeting, the ISQM 1 Task Force (TF) is of the view that proposed ISQM 1 does not warrant re-exposure.
2. This paper sets out the ISQM 1 TF's analysis of the provisions of the due process related to whether an approved ISQM needs to be re-exposed.

What Does the Due Process Require?

3. Appendix A includes relevant extracts from the IAASB's due process. The principal consideration in the due process is "whether there has been substantial change to the exposed document such that re-exposure is necessary." The related working procedures, which support the due process, include three examples of situations that may constitute potential grounds for a decision to re-expose:
 - (a) Substantial change to a proposal arising from matters not aired in the exposure draft (ED) such that commentators have not had an opportunity to make their views known to the IAASB before it reaches a final conclusion;
 - (b) Substantial change arising from matters not previously deliberated by the IAASB; or
 - (c) Substantial change to the substance of a proposed international pronouncement.

The ISQM 1 TF notes that there will almost always be changes to standards between an ED and final standard to be appropriately responsive to comments received on exposure; and this is true for proposed ISQM 1. In forming its view on re-exposure, the ISQM 1 TF has considered the reasons for re-exposure set out above and focused on these in determining its views for the purpose of this paper.

Considerations Relevant to the Development of the ISQM 1 TF's View on Re-Exposure

4. The objective of the project, as indicated in the project proposal, *Enhancing Audit Quality: Project Proposal for the Revision of the IAASB's International Standards Relating to Quality Control and Group Audits*, was to:
 - (a) Propose revisions to ISQC 1² to strengthen and improve a firm's management of quality for all engagements performed under the IAASB's International Standards by incorporating a quality management approach at the firm level, fostering the ability of the standard to be applied to a wide range of circumstances, and enhancing the requirements and application material.

¹ 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*

² International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements and Related Services Engagements*

- (b) Propose consequential amendments to other standards that may be necessary as a result of revisions to ISQC 1.
 - (c) Determine whether non-authoritative guidance and support tools should be developed by the IAASB or others to supplement the revisions.
5. The key elements addressed in the Exposure Draft of proposed ISQM 1 (ED-ISQM 1) were highlighted in the Explanatory Memorandum to ED-ISQM 1. These included:
- (a) Introducing a risk-based approach that addresses:
 - (i) Proactive management of quality, given the evolving environment in which firms operate, the intensifying focus on quality and the increasing expectations of firms' stakeholders;
 - (ii) Customizing the design, implementation and operation of the system of quality management (SOQM) based on the nature and circumstances of the firm and the engagements it performs, to facilitate the scalable application of the standard; and
 - (iii) Keeping the standard fit-for-purpose.
 - (b) Improving the robustness of firm governance and leadership, through:
 - (i) Addressing the expected behavior of firm leadership, the appropriate qualifications of leadership, leadership's ability to influence decisions about the firm's resources and leadership's performance evaluations;
 - (ii) Addressing the effect of the firm's strategic actions, including financial and operational decisions, on engagement quality and the firm's public interest role; and
 - (iii) Requiring leadership to evaluate the system annually.
 - (c) Addressing information and communication:
 - (i) Within the firm to enable the operation of the SOQM and performance of engagements; and
 - (ii) Externally, by promoting the exchange of valuable and insightful information about the firm's SOQM with stakeholders.
 - (d) Enhancing monitoring and remediation to:
 - (i) Promote more rigorous and proactive monitoring of the SOQM, including shifting the focus of the standard to monitoring all aspects of the system, and the need to tailor the monitoring activities; and
 - (ii) Improve the robustness of remediation, through clarified concepts addressing the identification of deficiencies, introducing a requirement to investigate the root cause(s) of deficiencies, and improving the requirements addressing the remediation of deficiencies.
 - (e) Addressing undue reliance on network requirements and network services through new requirements for firms to understand the network requirements or network services and the effect they have on the firm's SOQM, and emphasizing that the firm is responsible for its own SOQM.

- (f) Various other revisions to modernize and update the standard, including addressing the use of technological and intellectual resources in the SOQM and performance of engagements, and the use of external service providers.
6. Respondents to ED-ISQM 1 generally supported many of the proposals, however raised concerns that principally related to the following:
- (a) The scalability of the standard and firms appropriately tailoring the SOQM for their circumstances;
 - (b) The complexity and prescriptiveness of the requirements; and
 - (c) Developing a standard that can be applied in all circumstances, including when firms only perform related services engagements.
7. The ISQM 1 TF thoroughly considered these overarching concerns in developing the standard post-ED, and arriving at the draft presented in **Agenda Item 2-A**. In doing so, the ISQM 1 TF made a number of changes to address the principal concerns, while at the same time retaining the important concepts highlighted in paragraph 5, with modifications to these concepts to address respondents' specific comments on these areas. To facilitate an understanding of the change since ED-ISQM 1:
- (a) **Agenda Item 2-D** provides an explanation of the changes made to the standard since ED-ISQM 1; and
 - (b) **Agenda Item 2-E** compares, in a tabular form, the requirements in ED-ISQM 1 with **Agenda Item 2-A**.
8. The ISQM 1 TF considered the nature and extent of the changes made since ED-ISQM 1 to evaluate whether those changes are of such significance that re-exposure may be necessary, as outlined below in paragraphs 10–11. In summary, the ISQM 1 TF is of the view that the changes to the standard since ED-ISQM 1 have:
- (a) Clarified, but not substantially altered, the key elements addressed in ED-ISQM 1; and
 - (b) Not resulted in a departure from the objectives of the project outlined in paragraph 4.
9. The ISQM 2³ TF was responsible for the drafting of the specified response relating to engagements that are subject to engagement quality reviews (see paragraphs 34(f) and A133–A137 of **Agenda Item 2-A**). **Agenda Item 3-F** addresses, among other matters, the ISQM 2 TF' re-exposure considerations relating to this specified response.

Consideration of Nature and Extent of Changes since ED-ISQM 1

10. As highlighted above, **Agenda Item 2-D** explains the changes made to the standard since ED-ISQM 1. Key areas of change are as follows:
- (a) Various revisions to address respondents' principal concerns about scalability, tailoring, complexity, prescriptiveness and applicability. These included:
 - (i) Reordering the sequence of the components;

³ Proposed ISQM 2, *Engagement Quality Reviews*

- (ii) Refocusing the components on the quality objectives, by removing duplication between the quality objectives and responses, repurposing responses as quality objectives (where possible), and relocating responses to a discrete section “specified responses.”
 - (iii) Including more examples to demonstrate “scaling-up” and “scaling-down,” more clearly signposting scalability examples, and presenting examples in boxes (i.e., similar to the approach taken in ISA 315 (Revised));
 - (iv) Reducing the introduction, application material and appendix, with the intent of repurposing this material as guidance outside of the standard; and
 - (v) Rarticulating the requirements and application material to make them more succinct, direct or understandable.
- (b) Clarifying and simplifying the firm’s risk assessment process, to respond to respondents’ concerns that the process in ED-ISQM 1 was complex, confusing, overengineered, and challenging to implement, and to address observations about the “lack of” quality risks in ED-ISQM 1. The changes since ED-ISQM 1 include, in the context of clarifying how to identify and assess quality risks, explaining the conditions, events, circumstances, actions or inactions that may adversely affect the achievement of the quality objectives.
- (c) Adjusting the quality objectives and responses addressing external communications, recognizing respondents’ mixed views, through:
- (i) Removing the reference to “transparency reports” to address concerns from respondents that it may imply that a transparency report is required in all circumstances, when other effective means of communication may be more appropriate; and
 - (ii) Explicitly addressing communication with those charged with governance, given the encouragement from some respondents, particularly investors and regulators, to more robustly address communication externally and engagement with stakeholders.
- (d) With respect to monitoring and remediation:
- (i) Revising the requirement and application material addressing the selection of completed engagements for inspection, to address respondents’ suggestions to encourage a more proactive, risk-based and timely approach to monitoring, and to address scalability concerns in this component.
 - (ii) Clarifying the framework for evaluating findings and identifying deficiencies, given respondents’ views that the framework in ED-ISQM 1 was complex and unclear.
- (e) With respect to network requirements or network services, requiring that firms obtain from the network information about how the network determines that network requirements have been appropriately implemented across the network firms. This amendment was to address respondents’ views that the standard should encourage consistent and appropriate implementation across the network.
- (f) Clarifying the intent of the requirement for evaluating the SOQM, including the factors leadership may consider in performing the evaluation, the timing of the evaluation and how deficiencies may affect the evaluation. These changes were all in response to various comments from respondents.

11. The ISQM 1 TF notes that although many of the responses in ED-ISQM 1 were repurposed as quality objectives, or removed as they duplicated an existing quality objective, the matters addressed in the responses in ED-ISQM 1 have been retained in the requirements in the final standard (in some cases they were modified in response to respondent feedback on a particular response).

Task Force Views on Whether the Changes Necessitate Re-Exposure

12. The ISQM 1 TF has analyzed the relevant due process requirements and made the following observations:

- (a) Have the key elements of ISQM 1 changed, or have the objectives of the project changed?

As highlighted above in paragraph 10, while there have been many changes to proposed ISQM 1, the key elements of ED-ISQM 1 have been retained, with further clarifications and modifications in response to comments received on exposure. Therefore, the ISQM 1 TF is of the view that there have not been any substantial changes to key elements of proposed ISQM 1, from ED-ISQM 1. In addition, the ISQM 1 TF is of the view that the changes made since ED-ISQM 1 are coherent with the objectives of this project, and have not changed the project objectives outlined in paragraph 4.

- (b) Have significant new concepts been introduced?

The ISQM 1 TF is of the view that the changes made since ED-ISQM 1 have not introduced new concepts. In particular, the changes to address external communications were a balanced response to address the priorities and varying views across all stakeholder groups. Furthermore, the ISQM 1 TF notes that the requirement in proposed ISQM 1 addressing external communications promotes consistent application and supports transparent and balanced reporting to those charged with governance and other external parties, which is in the public interest.

- (c) Has there been adequate opportunity for the IAASB to be informed of stakeholder views before the IAASB reaches a final conclusion?

The ISQM 1 TF noted that there have been a number of targeted outreach activities since ED-ISQM 1 was issued, and three discussions with the IAASB Consultative Advisory Group (CAG). On balance, the ISQM 1 TF does not believe that the IAASB needs further consultation to further understand stakeholder views.

13. The ISQM 1 TF also considered whether there were other relevant factors that could be taken into account in determining whether re-exposure is necessary. These included:

- (a) Whether the IAASB will become aware of any new concerns by re-exposing proposed ISQM 1.⁴

- (b) The public interest considerations in delaying improvements to quality management, which are intended to improve audit quality, particularly given that this project has been ongoing since 2014.

⁴ By way of information, this is a relevant factor for the IASB in deciding whether to re-expose a standard. See paragraph 6.26 of their Due Process Handbook.

- (c) The impact of re-exposure on the implementation of the related quality management projects, proposed ISA 220 (Revised)⁵ and proposed ISQM 2, given the IAASB’s conclusion in June 2020 that the standards need to be implemented concurrently.
14. The ISQM 1 TF believes that re-exposing proposed ISQM 1 will not result in new information or concerns that have not been aired already through the comment letters on ED-ISQM 1 or the subsequent outreach and consultation activities. The ISQM 1 TF also notes that re-exposure of proposed ISQM 1 would delay the implementation of the standards significantly, which would be contrary to the public interest in driving improvements in engagement quality.

Implementation Recommendations

15. The ISQM 1 TF recognizes that the changes proposed in **Agenda Item 2-A** do not eliminate all implementation challenges that would have arisen from the implementation of ED-ISQM 1. While the ISQM 1 TF does not believe these challenges are a reason for re-exposure, the ISQM 1 TF believes that they give rise to a need for a strategic approach to implementation support, specifically:
- (a) The establishment of an implementation working group, if necessary, to provide a resource to respond to practical challenges encountered in the implementation of proposed ISQM 1;
 - (b) The issuance of non-authoritative support material, including:
 - (i) A “first-time implementation guide” explaining the significant changes from the extant standard, and incorporating diagrams and flowcharts as developed during the course of this project to illustrate various aspects of the standard; and
 - (ii) Frequently asked questions to explain concepts where further explanation of the intent of the standard would be helpful.
 - (c) A post-implementation review of proposed ISQM 1 three to four years after the effective date of the standard.

⁵ Proposed ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*

Appendix A

Relevant Extracts from the IAASB's Due Process

The IAASB's Due Process is available on the IAASB's website.⁶ The relevant material is paragraph 23 and A40–A42.

23. After approving the final revised content of an exposed international pronouncement, the PIAC⁷ votes on whether there has been substantial change to the exposed document such that re-exposure is necessary. An affirmative vote in accordance with the PIAC's terms of reference that re-exposure is necessary is required to issue a re-exposure draft. The basis of the PIAC's decisions with respect to re-exposure is recorded in the minutes of the PIAC meeting at which the related project is discussed. (Ref: Para. A40-A42)

...

Re-Exposure (Ref: Para. 23)

- A40. When an exposure draft has been subject to many changes, a summary comparative analysis is presented to the PIAC. This analysis shows, to the extent practicable, the differences between the exposure draft and the proposed final international pronouncement.
- A41. The senior staff member of the PIAC, in consultation with the Chair of the PIAC and chair of the Project Task Force, advises the PIAC on whether a draft international pronouncement, or part thereof, needs to be re-exposed.
- A42. Situations that constitute potential grounds for a decision to re-expose may include, for example: substantial change to a proposal arising from matters not aired in the exposure draft such that commentators have not had an opportunity to make their views known to the PIAC before it reaches a final conclusion; substantial change arising from matters not previously deliberated by the PIAC; or substantial change to the substance of a proposed international pronouncement.

⁶ www.ifac.org/system/files/uploads/PIAC-Due_Process_and_Working_Procedures.pdf

⁷ Public Interest Activity Committee, i.e. the IAASB.

Appendix B

Outreach and Consultation Activities Since ISQM 1 was Published

In addition to regular updates to the IAASB's Consultative Advisory Group (September 2019, March 2020 and September 2020), the following outreach was undertaken after the closure of the comment period on ED-ISQM 1 (i.e., since July 2019):

Q3 2019:

- Presentation at the DFK International and Asia Pacific Annual Conference
- Presentation at the South African Institute of Professional Accountants

Q4 2019

- Presentation to the Basel Committee on Banking Supervision's Audit Subgroup Members
- Meeting with U.S. Public Company Accounting Oversight Board
- Meeting with Center for Audit Quality Representatives
- Meeting with U.S. Securities and Exchange Commission Representatives
- Presentations at Crowe's Regional and International Conferences
- Presentation at the Quarterly Accountancy Europe Audit and Assurance Policy Group Meeting
- Meeting with the U.S. Auditing Standards Coordinating Forum at the Government Accountability Office
- Participation at the Hong Kong Institute of Certified Public Accountants' Annual Auditing Update Conference
- Presentation at PKF International Conference
- Presentation at the Committee of European Auditing Oversight Bodies
- Meeting with Shanghai Securities Regulatory Bureau and Shanghai Stock Exchange Representatives
- Meeting with Global Public Policy Committee Representatives
- Meeting with China Securities Regulatory Commission Representatives
- Observer at the China Securities Regulatory Commission Meeting
- Panel Participation at the U.S. Public Company Accounting Oversight Board Annual International Institute on Audit Regulation Conference
- Meeting with Chinese Institute of Certified Public Accountants Representatives

Q1 2020

- Meeting with Chinese Institute of Certified Public Accountants Representatives
- Presentation to Members of CPA Australia
- Meeting with Chinese Ministry of Finance Representatives

- Meeting with Representatives from RSM International and Baker Tilley
- Meeting with Representatives from Crowe LLP and PKF International
- Presentation at the International Organization of Securities Commissions' Committee on Issuer Accounting, Audit and Disclosure (Committee 1) Meeting
- Meeting with International Association of Insurance Supervisors Representatives
- Meeting with Basel Committee on Banking Supervision Representatives
- Presentation to Small- and Medium-Practices Committee Representatives
- Presentation to Forum of Firms and Global Public Policy Committee Representatives

Q2 2020

- Meeting with National Auditing Standards Setters (specifically on the effective date of the proposed quality management standards)
- Meeting with Global Public Policy Committee Representatives (specifically on effect of COVID-19 on implementation efforts)
- Presentation to Crowe Global - Americas Region
- Meeting with International Forum of Independent Audit Regulators' Standards Coordination Working Group and Global Audit Quality Working Group Representatives
- Meeting with the Chief Auditor of the U.S. Public Company Accounting Oversight Board
- Meeting with the Public Interest Oversight Board representatives