

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

### Overview

In June 2020, the ISQM 1 Task Force (TF) presented a portion of proposed ISQM 1, focused on areas where the ISQM 1 TF had previously received the most comments, or areas of more complexity and differing views. The goal of the June 2020 discussion was to achieve consensus from the Board on the areas presented, and to facilitate the approval of the standard in September 2020. The ISQM 1 TF has not redeliberated matters where Board consensus has been achieved, and these matters have therefore not been discussed further in this issues paper.

This paper explains the changes to proposed ISQM 1 in response to Board comments raised in June 2020 and March 2020 (on items not presented in June). It also outlines the deliberations by the ISQM 1 TF on the objective of proposed ISQM 1, in response to addressing the Public Interest Oversight Board's (PIOB) public interest issues on the objective. This paper is organized as follows:

- (a) Various matters related to human resources;
- (b) The objective of proposed ISQM 1;
- (c) The firm's risk assessment process;
- (d) Relevant ethical requirements;
- (e) External communication; and
- (f) Other changes.

### Objective of the Discussion

The objective of this agenda item is to approve proposed ISQM 1.

## A. Introduction

1. The proposals in **Agenda Item 2-B** (the draft of proposed ISQM 1), which are explained in this issues paper, have been developed in response to the Board feedback:
  - (a) In the June 2020 meeting, with respect to the items presented in June 2020; and
  - (b) In the March and April 2020 meetings, with respect to the items that were not presented in June 2020.

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<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*

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

2. 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>	Draft minutes of the June 2020 IAASB discussion
<b>Agenda Item 2-A</b>	Draft of proposed ISQM 1 (Clean)
<b>Agenda Item 2-B</b>	Draft of proposed ISQM 1 (Track Changes from March 2020 and June 2020)
<b>Agenda Item 2-C</b>	Re-exposure Paper
<b>Agenda Item 2-D</b>	Tracking of Changes Since ED
<b>Agenda Item 2-E</b>	Table of Comparison: Requirements in ED to Final Standard

*Structure of the Board Discussion*

3. The draft that will be referenced for purposes of the Board discussion will be the track change version of proposed ISQM 1 (**Agenda Item 2-B**).
4. During the sessions on Monday, September 14<sup>th</sup> and Tuesday, September 15<sup>th</sup>, the Chair of the ISQM 1 TF will first address various matters related to human resources (see **section B.1** below). Thereafter, the Chair of the ISQM 1 TF will walk the Board through the entire standard, from beginning to end, in the groupings indicated below. As the Chair walks through the standard, the Board will be asked:
- (a) Specific questions, as indicated in the sections that follow in this paper; and
  - (b) For each section of the standard, the Board's views on the revisions to proposed ISQM 1 (see **question 5**).

<b>Monday, September 14th</b>	
Various Matters Related to Human Resources (see <b>section B.1</b> below)	16(n), 16(v), 20, 21, A21–A22, A34, A72, A94–A97
Introduction, Authority of ISQM 1, and Effective Date	1–13, A1–A9
Objective (see <b>section B.2</b> below)	14–15
Definitions	16, A10–A28
Applying and Complying with Relevant Requirements	17–18, A29
System of Quality Management	19–22, A30–A38
The Firm's Risk Assessment Process (see <b>section B.3</b> below)	23–27, A39–A54
Governance and Leadership, Relevant Ethical Requirements (see <b>section B.4</b> below)	28–29, A55–A66
Acceptance and Continuance of Client Relationships and Specific Engagements, Engagement Performance*	30–31, A67–A85

<b>Tuesday, September 15th</b>	
Resources	32, A86–A108
Information and Communication, Specified Responses (see <b>section B.5</b> below)	33, 34(a)–34(e), A109–A132
Monitoring and Remediation	35–47, A138–A173
Network Requirements or Network Services	48–52, A174–A185
Evaluating the System of Quality Management	53–56, A186–A200
Documentation	57–60, A201–A205

\* Please note that paragraphs 34(f) and A133–A137 dealing with engagement quality reviews will be discussed by the Board as part of the ISQM 2 session on Wednesday, September 16.

5. Following these two sessions on ISQM 1, the planned approach is as follows:
  - (a) Significant issues raised by the Board on targeted areas will be brought back for discussion on Friday, September 18<sup>th</sup>. It is anticipated that the drafting of the targeted areas will be provided to the Board by 9am ET on Thursday, September 17<sup>th</sup>.
  - (b) The standard will be presented for approval on Wednesday, September 23<sup>rd</sup>. The ISQM 1 TF Chair will walk through the entire standard in order of sequence, and in the same groupings as indicated in the table above. The Board will be asked to vote on approving the standard. It is anticipated that the final standard will be provided to the Board by 12pm ET on Monday, September 21<sup>st</sup>.
6. After the vote on the approval of proposed ISQM 1, the ISQM 1 TF Chair will ask for overall views about the ISQM 1 TF's analysis of the provisions of due process related to whether the approved standard needs to be re-exposed (see **Agenda Item 2-C**).

## **B. ISQM 1 TF's Proposals on Proposed ISQM 1**

### **B.1 Various Matters Related to Human Resources**

<b>Relevant Paragraphs in Agenda Item 2-B</b>			
Requirements	Application Material	Definitions	Other
20, 21	A34, A72, A94-A97	16(n), 16(v), A21–A22	N/A

7. In response to the Board's comments in June 2020, the following amendments have been made in **Agenda Item 2-B** related to human resources:
  - (a) The introductory material describing the use of terms in proposed ISQM 1 that relate to human resources has been removed (see paragraph 13B). This material has been replaced by:
    - (i) Reinstating the definition of personnel (see paragraph 16(n)); and
    - (ii) Adding application material to clarify that other *individuals* may be used by the firm in performing activities in the system of quality management (SOQM) or in performing engagements (see paragraph A22).

Given the definition of engagement team already exists in proposed ISQM 1, there was no need to add additional material to explain this term.

- (b) The definition of service providers has been updated to remove the reference to “engaged by the firm,” so that it does not inadvertently exclude circumstances when the firm uses a component auditor who was engaged by the client or management of the component (see paragraph 16(v)).
  - (c) Paragraph A28 was added to clarify that the firm’s policies or procedures that apply to individuals external to the firm may be different from the policies or procedures that apply to personnel.
  - (d) The application material in the resources component explaining the assignment of resources to the engagement has been simplified and clarified (see paragraphs A95–A97). Furthermore, an example was added in paragraph A178 to demonstrate how, when using another network firm as a component auditor, the firm may adapt or supplement the use of the component auditor. This example effectively replaces paragraph A120C, which has been deleted. In revising the application material, the ISQM 1 TF focused on reducing the complexity of the explanations, in response to the Board’s suggestions in June 2020.
8. Given the updates to resources, paragraph A72 of **Agenda Item 2-B** (acceptance and continuance) has also been revised to emphasize the firm’s responsibility for providing appropriate resources to the engagement team with respect to component auditors (i.e., if there are no appointed component auditors, the firm may need to obtain a component auditor or the engagement team may obtain a component auditor in accordance with the firm’s policies or procedures).
9. The ISQM 1 TF considered the appropriate use of the term “individual” for assigning responsibilities related to the SOQM (e.g., ultimate responsibility and accountability for the SOQM), given the Board’s concern that “individuals,” as described in proposed ISQM 1, can include persons external to the firm. The ISQM 1 TF is of the view that there could be circumstances when these roles are assigned to individuals who, from a legal entity standpoint, are not personnel of the firm. The ISQM 1 TF notes the requirement in paragraph 21 of **Agenda Item 2-B**, which requires the individual(s) assigned these roles to have the appropriate influence and authority within the firm. Paragraph A34 of **Agenda Item 2-B** has been added to emphasize this point and clarify that typically the individual(s) would be a partner of the firm.

**Matter for Board Consideration**

- 1. Does the Board agree with the revisions made addressing various matters related to human resources?

**B.2 The Objective of Proposed ISQM 1**

Relevant Paragraphs in Agenda Item 2-B			
Requirements	Application Material	Definitions	Other
14–15	N/A	N/A	N/A

- 10. In March 2020, the ISQM 1 TF presented the feedback from respondents on question 5 of the Exposure Draft of ISQM 1 (ED-ISQM 1), dealing with the objective of ED-ISQM 1 and how the

standard addresses the firm's role relating to the public interest. As noted in [Agenda Item 4](#) of the March 2020 meeting, respondents had mixed views regarding the reference to public interest in the standard, and the PIOB has identified, as one of its public interest issues, the need for the objective to include a focus on high-quality audits.

11. The ISQM 1 TF had responded to the feedback by revising the introductory material explaining the public interest and the link to the objective of the standard (previously paragraph 7 of **Agenda Item 2-B**), and the Board supported the revisions. However, the PIOB has continued to emphasize the need for the objective of the standard to focus on quality engagements (see the [PIOB website](#)), including in recent engagements with them.
12. The ISQM 1 TF deliberated extensively whether, and if so how, the objective of the standard could be more focused on quality engagements. The ISQM 1 TF noted that:
  - (a) A quality engagement is achieved when the practitioner fulfils their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, conducts the engagement in accordance with such standards and requirements, and issues an engagement report that is appropriate in the circumstances. ISA 220 (Revised)<sup>2</sup> addresses the management of quality at the engagement level, including a requirement for the engagement partner to take overall responsibility for managing and achieving quality on the audit engagement.
  - (b) The role of the firm is to enable the consistent performance of quality engagements through designing, implementing and operating a SOQM that provides the firm with reasonable assurance that the objectives in paragraph 14(a) and (b) are achieved. Accordingly, the objective of proposed ISQM 1 needs to remain focused on the firm establishing a system to enable the performance of quality engagements, rather than the firm individually managing the quality of engagements.
  - (c) Introductory material had been included in ED-ISQM 1 (previously paragraph 7 of **Agenda Item 2-B**) to:
    - (i) Emphasize the public interest;
    - (ii) Clarify that the public interest is served by the consistent performance of quality engagements and clarify when a quality engagement is achieved; and
    - (iii) Connect the public interest to the objective of the standard.
  - (d) The objective of proposed ISQM 1 needs to provide a clear outcome-based reference for the firm in evaluating whether the objective has been achieved. An objective that incorporates aspirational elements is by its nature not capable of clear and consistent evaluation.
13. Through its deliberations, the ISQM 1 TF concluded that that the objective in paragraph 14 of **Agenda Item 2-B** remains appropriate. Nevertheless, the ISQM 1 TF identified that the introductory material explaining the public interest may be better placed in closer proximity to the objective to provide a better linkage to the objective. As a result, the ISQM 1 TF has proposed repositioning the introductory material as essential material to the objective (see paragraph 15 of **Agenda Item 2-B**), since it:

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<sup>2</sup> Proposed ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*

- (a) Clarifies how the public interest and consistent performance of quality engagements are related to the objective of the standard, because of its closer proximity to the objective;
- (b) Improves the prominence of the public interest in the standard; and
- (c) Facilitates a proper understanding of the objective of the standard and how the requirements are designed to achieve the objective.

It is noted that the piece of the introductory material explaining the objectives of the system has been relocated to paragraph 9 of **Agenda Item 2-B**.

14. The ISQM 1 TF considered whether essential material to the objective is an appropriate approach in the context of general drafting conventions. The ISQM 1 TF noted that in the IAASB’s current standards, essential material to the objective has been used in ISA 200,<sup>3</sup> ISRE 2400 (Revised)<sup>4</sup> and ISAE 3000 (Revised).<sup>5</sup> Essential material to the objective is not application material by nature, or similar to essential application material. It is material that is fundamentally linked to the objective of the standard and positioning it alongside the objective is necessary for a proper understanding of the objective and the requirements.

<b>Matters for Board Consideration</b>	
2.	Does the Board agree that the objective in paragraph 14 of <b>Agenda Item 2-B</b> remains appropriate?
3.	Does the Board support positioning the public interest paragraph with the objective (see paragraph 15 of <b>Agenda Item 2-B</b> )?

**B.3 The Firm’s Risk Assessment Process**

<b>Relevant Paragraphs in Agenda Item 2-B</b>			
Requirements	Application Material	Definitions	Other
23–27	A39–A54	N/A	N/A

15. The ISQM 1 TF has made the following revisions to the firm’s risk assessment process in **Agenda Item 2-B** in response to the Board feedback in June 2020:
- (a) The example in paragraph A39 regarding how firms may apply the firm’s risk assessment process has been clarified.
  - (b) Paragraph A11C, which explained the judgments made by the firm in identifying and assessing quality risks and how risks give rise to quality risks, has been revised and relocated to paragraphs A46 and A48.
  - (c) Paragraph 27(a) has been revised to include a possible modification of the quality objectives, and paragraph A54 clarifies what the modification may include, i.e., that it relates to the quality objectives established by the firm in addition to those specified in the standard, which may be

<sup>3</sup> ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

<sup>4</sup> ISRE 2400 (Revised), *Engagements to Review Historical Financial Statements*

<sup>5</sup> ISAE 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*

modified by the firm due to changes in the nature and circumstances of the firm or its engagements.

16. The ISQM 1 TF considered the varying suggestions from the Board to add further specific examples to paragraph A46 of **Agenda Item 2-B** (i.e., the examples of conditions, events, circumstances, actions or inactions, and quality risks that may arise from them) while also noting the feedback from the Board in March 2020 to keep the examples concise. The ISQM 1 TF concluded that the examples provided cover a sufficiently broad range of scenarios to illustrate the requirement, and further examples could be included in the supplementary implementation guidance.

#### B.4 Relevant Ethical Requirements

Relevant Paragraphs in Agenda Item 2-B			
Requirements	Application Material	Definitions	Other
29	A62–A66	16(t), A23–A25	N/A

##### *Applicability of Relevant Ethical Requirements to the Network and Service Providers*

17. In response to the Board’s feedback in June 2020, the ISQM 1 TF considered the applicability of relevant ethical requirements to the network or service providers. In doing so, Staff engaged with IESBA<sup>6</sup> staff to clarify the application of the IESBA Code<sup>7</sup> to a number of different scenarios.
18. The ISQM 1 TF determined that while the IESBA Code does not explicitly contain requirements for “service providers,” relevant ethical requirements may be applicable to service providers in multiple ways, for example:
- (a) A service provider performing work on the firm’s engagement and who falls within the definition of engagement team is subject to the relevant ethical requirements that apply to members of the engagement team. For example, the firm uses an offshore service provider to prepare lead schedules for an audit. The definition of “engagement team” in the IESBA Code<sup>8</sup> includes “all partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform assurance procedures on the engagement...”. As a result, in this case, the individuals from the service provider are considered part of the engagement team.
  - (b) A service provider performing an engagement quality review for the firm is subject to the relevant ethical requirements that apply to engagement quality reviewers in the context of the firm and the engagement subject to engagement quality review.
19. While the IESBA Code does not specify requirements for the network, the ISQM 1 TF is of the view that proposed ISQM 1 should be principles-based and include a reference to the network because:
- (a) The relevant ethical requirements to which the firm is subject may have certain provisions that apply to individuals from the network, as a result of the activities they are performing for the firm (e.g., consultation, monitoring or engagement quality reviews).

<sup>6</sup> The International Ethics Standards Board for Accountants

<sup>7</sup> *International Code of Ethics for Professional Accountants (including International Independence Standards)*

<sup>8</sup> The IESBA currently has a project underway to consider the definition of engagement team and the applicability of the independence requirements in the IESBA Code to individuals within the definition. For further information, please refer to their project page, <https://www.ethicsboard.org/consultations-projects/engagement-team-group-audits-independence>.

- (b) The relevant ethical requirements that apply may be a jurisdictional code or may include ethical rules in law or regulation, and they could include requirements that affect the firm’s network.
  - (c) Revisions to the IESBA Code may arise in the future that affect the firm’s network.
20. Taking into account the applicability of relevant ethical requirements to the network or service providers as described above, the ISQM 1 TF is of the view that the quality objective relating to relevant ethical requirements is appropriate.

*Other Matters Related to Relevant Ethical Requirements*

21. In finalizing proposed ISQM 1, the Chair of the ISQM 1 TF and Staff met with IESBA Representatives and Staff to discuss any final coordination matters. IESBA Representatives and Staff were provided with a full draft of proposed ISQM 1 prior to the meeting. IESBA Representatives and Staff had a number of suggestions, and the standard was updated to reflect their suggestions. Their suggestions included:
- (a) Adding references to Parts 3 and 4 of the IESBA Code in paragraph A25 of **Agenda Item 2-B**, as they indicated that there was an imbalance in the application material explaining Part 2 of the IESBA Code, relative to the other parts of the IESBA Code.
  - (b) Adjusting the example in paragraph A65 of **Agenda Item 2-B** describing the definition of engagement team in relevant ethical requirements, given IESBA’s current project on the definition of engagement team and the possibility that a different term may be developed.
  - (c) Clarifying the example in paragraph A112 of **Agenda Item 2-B**, regarding the information the firm may obtain from the network.

**B.5 External Communication**

Relevant Paragraphs in Agenda Item 2-B			
Requirements	Application Material	Definitions	Other
34(e)	A124–A132	N/A	N/A

22. The ISQM 1 TF considered whether the location of the requirement to communicate with those charged with governance of listed entities for which the firm performs audit engagements is appropriate in proposed ISQM 1, or whether it is better located in ISA 260 (Revised).<sup>9</sup> The ISQM 1 TF remains of the view that proposed ISQM 1 is the appropriate location for this material because:
- (a) The requirement is framed in the context of the firm establishing policies or procedures addressing the communication, and therefore places a responsibility on the firm to consider the nature, timing and extent of the communication, and the form and manner in which it is undertaken (i.e., shifting it to the ISA may shift the responsibility to the engagement team);
  - (b) Although the requirement is focused on audits of listed entities, it may be appropriate to communicate with those charged with governance of entities other than listed entities, or when performing other engagements (e.g., other assurance engagements performed in accordance with ISAE 3000 (Revised));

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<sup>9</sup> ISA 260 (Revised), *Communication with Those Charged with Governance*

- (c) The content of the communication is focused on the firm, and there may be circumstances when the firm (i.e., not the engagement team) communicates with those charged with governance; and
- (d) The application material supporting the requirement is also relevant to other external communications (i.e., the application material would need to exist in both proposed ISQM 1 and ISA 260 (Revised) if the requirement were relocated to ISA 260 (Revised)).

The ISQM 1 TF notes that a reference to proposed ISQM 1 has been included in the conforming amendments to ISA 260 (Revised), presented in [Agenda Item 2](#) of the July 22, 2020 IAASB meeting.

23. In response to the Board's feedback in June 2020, the ISQM 1 TF has proposed the following in **Agenda Item 2-B**:

- (a) The requirement to communicate with those charged with governance has been separated into a discrete requirement and revised to clarify what the communication relates to (see paragraph 34(e)(i)). In considering these changes, the ISQM 1 TF noted that the intent of communicating with those charged with governance is to share information with them to support their understanding of how the firm, through its SOQM, enables the consistent performance of quality audits. The ISQM 1 TF affirms its view that a principles-based requirement is most suitable (i.e., instead of listing matters to be communicated), since it focuses the firm on providing information that is relevant in the circumstances.
- (b) Paragraph A126 has been clarified to indicate that the information that is communicated to those charged with governance may be the items listed in the paragraph (in previous drafts, this was not obvious).
- (c) Paragraph A127 has been added to point out that how the communication is undertaken may vary; it emphasizes that in some cases it may be done by the firm itself, rather than the engagement team.
- (d) Paragraph A132 has been added to include a public sector example of when it may be appropriate to communicate with those charged with governance.

24. The ISQM 1 TF considered the suggestion by the Board that the application material referring to ISA 260 (Revised) should be removed. However, the ISQM 1 TF believes that the application material is helpful, because it highlights aspects of ISA 260 (Revised) that may assist in determining with whom to communicate and the communication process.

**Matter for Board Consideration**

4. Does the Board support the revisions related to external communications?

**B.6 Other Changes**

25. The ISQM 1 TF has made a number of general changes to the standard, including:

- (a) Aligning drafting with proposed ISA 220 (Revised) and proposed ISQM 2<sup>10</sup>;
- (b) Clarifications, simplifying the language, or aligning the language to other areas of proposed ISQM 1; and

<sup>10</sup> Proposed ISQM 2, *Engagement Quality Reviews*

- (c) Removing some of the example boxes, given the Board's previous suggestions to reduce the extensive use of boxes.

26. The ISQM 1 TF notes the following specific changes reflected in **Agenda Item 2-B**:

*System of quality management:*

- (a) Paragraph 20 dealing with the assignment of responsibilities related to the SOQM was clarified in response to the Board's suggestion in March 2020.
- (b) Paragraph A31 was changed to align to the IESBA's project on the role and mindset expected of professional accountants.
- (c) Paragraphs A33 and A35 were revised to clarify:
  - (i) The roles and responsibilities with respect to the SOQM, including those of the firm.
  - (ii) That certain tasks may be delegated, although responsibility remains with the individual or the firm.
- (d) Paragraph A37, which explains that leadership may be subject to certain qualification requirements in law or regulation, was added in response to a suggestion from the Board in March 2020.

*Governance and leadership:*

- (e) Paragraph 28(a) was revised as the ISQM 1 TF received a number of offline comments from the Board that the quality objective lacked clarity or appeared aspirational.
- (f) Paragraph A31A, which provided examples of how the roles and responsibilities may be assigned in a less complex and a more complex firm, was removed as it was duplicative of the example in paragraph A35.

*Engagement performance:*

- (g) The reference to "the nature and circumstances of the engagements and the resources assigned or made available to the engagement teams" in paragraph 31(b) was removed since these are considerations in identifying and assessing quality risks.
- (h) Paragraphs A83 and A85, dealing with the assembly and retention of engagement documentation, were revised because it was noted that the manner in which they were drafted appeared substantially different from extant ISQC 1, and the corresponding engagement-level standards that contain similar material (ISA 230<sup>11</sup> and ISAE 3000 (Revised)). This issue was also noted by the Board in the July 22, 2020 meeting on the conforming amendments.

*Specified responses:*

- (i) The lead in of paragraph 34 and paragraph A116 were updated to address a comment from the Board in March 2020 that more clarity is needed about the connection between the specified responses and the related quality objectives.
- (j) Paragraph 34(c) was amended to clarify what complaints and allegations relate to, and align to the requirement in extant ISQC 1. Corresponding changes have been made in other areas of the standard that refer to complaints and allegations (e.g., paragraph 37(f)).

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<sup>11</sup> ISA 230, *Audit Documentation*

*Monitoring and remediation process:*

- (k) Paragraph A144 was revised such that it is clearer that the firm should monitor the design of the monitoring and remediation process, and to explain how this may be operationalized in a less complex firm. This was in response to the Board's feedback in June 2020.
- (l) Paragraph A153 was adjusted to remove the reference to "listed entities" in the context of the selection of engagement partners for inspection. This was in response to an offline comment from a Board member in June 2020 indicating that paragraph A66 of extant ISQC 1 does not differentiate between audits of listed entities and other audit engagements in the context of the three-year inspection cycle.
- (m) Paragraph A157 was adjusted to indicate that the firm needs to gather the findings from the monitoring activities, in order to evaluate the findings and identify the deficiencies, as suggested by the Board in June 2020.
- (n) Paragraph 47 was updated to be clear about which individuals it is referring to because of the broader meaning of individuals, in response to the Board suggestion in June 2020. Similar changes were made elsewhere in the standard.
- (o) Throughout the standard, references to "deficiency" and "identified deficiency" were updated for consistency. The term "identified deficiency" has been used to refer to deficiencies that have already been identified by the firm, and the term "deficiency" has been used to refer to possible deficiencies (i.e., they are not yet known).

*Network Requirements or Network Services:*

- (p) Paragraph A179, which focuses on the firm communicating possible improvements to the network requirements or network services, was added in response to outreach feedback from Monitoring Group Members, who noted the importance of encouraging best practices across the network.
- (q) The example that was in paragraph A199 (see deleted paragraph before paragraph A180), which aimed to illustrate how the monitoring activities undertaken by the network may affect the nature, timing and extent of the firm's monitoring activities, was removed as a result of an offline comment in March 2020 indicating that it may be taken to imply that, in all cases, the firm does not need to inspect the engagements inspected by the network. The ISQM 1 TF explored further clarifying the example to address the comment, but noted that doing so would result in an example that would not provide much clarity or benefit.

*Evaluation of the SOQM*

- (r) Paragraph 54 was adjusted to focus on the firm concluding on the SOQM, rather than the individual assigned ultimate responsibility for the SOQM. This change was made to clarify that, although the individual assigned ultimate responsibility and accountability for the SOQM has a responsibility for the system, the firm cannot abdicate its responsibility for designing, implementing and operating the system (see also paragraph A33). The ISQM 1 TF had previously tried to convey this point through the application material in paragraph A186, but given the Board's feedback in June 2020, resolved to rather adjust the requirement. Accordingly, paragraph A186 has been simplified as there is no longer a need to describe this point in the application material.

- (s) Paragraph 55 was adjusted to reflect that the firm may also need to take further actions when its conclusion is in accordance with paragraph 54(b), i.e., that, except for matters related to identified deficiencies that have a severe but not pervasive effect on the design, implementation and operation of the SOQM, the SOQM provides the firm with reasonable assurance that the objectives of the SOQM are being achieved).

*Documentation*

- (t) Some of the factors in paragraph A202 were removed, given the Board's feedback in March 2020 that they could drive inconsistent approaches to documentation across networks.
  - (u) Paragraph A204 was updated to further clarify the documentation with respect to identifying and assessing quality risks, given the Board's feedback in March 2020.
27. The ISQM 1 TF considered the Board's suggestion in March 2020 to reinstate the quality objective addressing access to information that had previously been included in the acceptance and continuance component.<sup>12</sup> The ISQM 1 TF noted that access to information and persons is dealt with in the relevant engagement standards, for example, in ISA 210<sup>13</sup> it is a required precondition for an audit. Furthermore, the ISA 600<sup>14</sup> TF has robustly addressed access issues in ED-ISA 600. The ISQM 1 TF is of the view that the objective in paragraph 30(a) of proposed ISQM 1 appropriately addresses the issue in a principles-based way, as it focuses on the firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements.

**Matter for Board Consideration**

- 5. As the Board walks through the entire standard in the groupings indicated in paragraph 5, the Board is asked for its views on the revisions to proposed ISQM 1.

**C. Due Process Matters**

**C.1 Significant Matters Identified by the Task Force**

28. In the ISQM 1 TF's view, the significant matters it has identified as a result of its deliberations since the beginning of this project, and its conclusions and recommendations thereon, have been reflected in the agenda material presented to the Board at its meetings. In the ISQM 1 TF's view, there are no significant matters discussed in the course of this project that have not been brought to the Board's attention.

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<sup>12</sup> Paragraph 34(b) of Agenda Item 7-A of the December 2019 meeting indicated the following:

*The firm makes appropriate judgments about the firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements when determining whether to accept or continue a client relationship or specific engagement, including that the firm has:*

- (i) *Resources to perform the engagement; and*
- (ii) *Access to information to perform the engagement, or to the persons who provide such information.*

<sup>13</sup> ISA 210, *Agreeing the Terms of Audit Engagements*

<sup>14</sup> ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

## **C.2 Consideration of the Need for Re-Exposure**

29. The ISQM 1 TF considered whether re-exposure is needed and believes, based on the draft that is presented to the Board for the September 2020 meeting, that it is not. **Agenda Item 2-C** presents the ISQM 1 TF's analysis of the provisions of due process related to whether the approved ISQM needs to be re-exposed and its conclusion, along with other background material that may assist the Board in coming to a view on re-exposure. **Agenda Item 2-D** provides an overview of changes since ED and when matters were discussed with the Board, and **Agenda Item 2-E** shows a detailed comparison of the requirements in ED-ISQM 1 to the requirements in proposed ISQM 1, as presented in **Agenda Item 2-A**.

## Overview of ISQM 1 TF's Activities

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 [ISQM 1 project](#).

### ISQM 1 Task Force Activities in Quarter 3 of 2020

2. In the 3rd quarter of 2020, the ISQM 1 TF held five videoconferences.

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

#### *Coordination between ISQM 1 TF, ISA 220 TF, ISQM 2 TF and ISA 600 TF*

3. In the 3<sup>rd</sup> quarter of 2020, representatives of each TF were selected to cross-review the draft standards of the other quality management projects, with a focus on the alignment of the three standards.
4. In the 3<sup>rd</sup> quarter of 2020, the ISQM 1 Staff, ISQM 2 Staff and ISA 220 Staff also met to discuss coordination matters. Staff also performed a cross-review of the standards, and prior to the final posting of the standards for the September 2020 meeting, updated the standards to ensure the drafting is appropriately aligned. Any final changes that are needed to align the standards and which arise from final revisions to the standards, will be identified by Staff and adjusted in the respective standards.

#### *Coordination with IESBA*

5. IESBA Representatives and Staff were provided with a full draft of proposed ISQM 1 and a final coordination call was held with them to discuss any final matters.
6. Staff also held a call with IESBA Staff to discuss the applicability of the IESBA Code to others (i.e., networks, network firms and service providers).

## Appendix 2

### Draft Minutes of the June 2020 IAASB Discussion

Ms. Corden presented the ISQM 1 Task Force's proposals on certain sections of proposed ISQM 1, as reflected in **Agenda Item 5-A**.

#### THE FIRM'S RISK ASSESSMENT PROCESS, INCLUDING THE DEFINITION OF QUALITY RISK

The Board broadly supported the changes to the firm's risk assessment process (FRAP) and the revised definition of "quality risk." The Board provided further specific comments regarding the firm's risk assessment process, including the following:

- Clarifying paragraph A11C of **Agenda Item 5-A** to indicate that determining the degree to which a risk may adversely affect the achievement of a quality objective forms part of determining whether a risk is a quality risk.
- Clarifying the example in paragraph A24F of **Agenda Item 5-A** regarding how firms may apply the FRAP.
- Enhancing the examples of conditions, events, circumstances, actions or inactions, and quality risks that may arise from these, in paragraph A24N of **Agenda Item 5-A**.
- Clarifying that quality objectives established by the firm, in addition to those specified in proposed ISQM 1, may be modified by the firm due to changes in the nature and circumstances of the firm or its engagements.

#### MONITORING AND REMEDIATION, INCLUDING THE DEFINITIONS OF DEFICIENCY AND FINDINGS

The Board broadly supported the changes to the definitions of "deficiency" and "findings" and the related application material, as well as the changes to the monitoring and remediation section. The Board provided further specific comments, including recommendations to:

- Revise paragraph A161B of **Agenda Item 5-A** related to the firm's monitoring activities over the monitoring and remediation process to:
  - Clarify that the firm should monitor the design of the monitoring and remediation process; and
  - Refine the scalability examples.
- Add application material to indicate that the firm needs to gather the findings from the activities undertaken in accordance with paragraphs 44-45 of **Agenda Item 5-A**, in order to evaluate the findings and identify the deficiencies.

#### EVALUATION OF THE SYSTEM OF QUALITY MANAGEMENT (SOQM)

The Board broadly supported the changes to the requirements and application material for the evaluation of the SOQM. Further recommendations included:

- Considering whether it is appropriate to refer to other individuals in the requirements in paragraphs 53 and 65C of **Agenda Item 5-A**, given that the term "individuals" includes those external to the firm.
- Clarifying the intent of paragraph A209A of **Agenda Item 5-A**, including the respective responsibilities of the firm and the individual(s) assigned ultimate responsibility and accountability for the SOQM.

#### RELEVANT ETHICAL REQUIREMENTS

In general, the Board indicated a preference for option 1 presented in paragraph 32 of **Agenda Item 5-A**, with respect to the quality objective addressing relevant ethical requirements. The Board encouraged the ISQM 1 Task Force to clarify with IESBA the applicability of the relevant ethical requirements to individuals from the network or a service provider.

#### HUMAN RESOURCES, INCLUDING THE FIRM'S RESPONSIBILITIES WITH RESPECT TO COMPONENT AUDITORS, AND SERVICE PROVIDERS

The Board supported the principles proposed by the ISQM 1 Task Force with respect to human resources, including the changes to the requirement in paragraph 38 of **Agenda Item 5-A**. Further recommendations included:

- Simplifying the application material in paragraphs A120–A120E of **Agenda Item 5-A**, relating to engagement team members, and relocating certain paragraphs to the network requirements and network services section.
- Clarifying that non-network firms used as component auditors may not necessarily be “engaged by the firm,” as implied in the definition of service provider.
- Considering the appropriate use of the term “personnel”, “individuals” and “engagement teams” throughout the standard, and also considering whether the terms should be defined. Reconsidering whether it is appropriate to use the term “individual” in the context of assigning responsibilities related to the SOQM (e.g., ultimate responsibility and accountability for the SOQM), since “individuals” can be persons external to the firm.

#### EXTERNAL COMMUNICATIONS

On balance, the Board expressed support for the proposals addressing external communications, including the proposal to explicitly communicate with those charged with governance of listed entities for which the firm performs audit engagements (see **Agenda Item 5-D**). Further recommendations included:

- Exploring the appropriate location of the requirement to communicate with those charged with governance of listed entities for which the firm performs audit engagements, i.e., it may be better suited in ISA 260 (Revised)<sup>15</sup> as a conforming amendment.
- Removing the application material referring to ISA 260 (Revised).
- Separating the requirement to communicate with those charged with governance from the broader requirement that addresses when it is appropriate to communicate with external parties.
- Adding the public sector as an example of when it may be appropriate to communicate with those charged with governance, in the application material.

#### PIOB OBSERVER REMARKS

Ms. Stothers indicated that all of the issues had been covered and successfully concluded. Ms. Stothers noted that the IAASB held a robust discussion regarding external communication and suggested that the ISQM 1 Task Force should consider discussing the matter further with the Board before the approval of the

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<sup>15</sup> ISA 260 (Revised), *Communication with Those Charged with Governance*

standard in September 2020. Ms. Stothers also asked about the interactions with Monitoring Group Members related to the quality risk definition.

#### WAY FORWARD

The ISQM 1 Task Force will present ISQM 1 for approval at the September 2020 IAASB videoconference. The ISQM 1 Task Force will also continue its coordination activities with the ISQM 2, ISA 220 and ISA 600 Task Forces and IESBA.