Quality Management—Coordination, Effective Date, and Implementation Support

Objectives of the IAASB discussion

The objectives of this Agenda Item are to:

(a) Inform the Board about the coordination between the Quality Management (QM)\(^1\) Task Forces;
(b) Obtain input on the options for the effective date of the QM standards; and
(c) Provide a high-level overview of respondents’ comments on possible implementation support activities.

Section I. Coordination Between the QM Task Forces and with IESBA\(^2\)

1. In Q2, 2020, a focus of the QM Task Forces has been coordinating to resolve alignment issues between the standards and to ensure coordinated responses to remaining issues. To this end:
   - The Task Force Chairs and staff met twice times to discuss the process of coordination and joint issues, such as the effective date of the QM standards;
   - Task Force representatives met bilaterally as needed to address issues of mutual interest;
   - Project staff cross-read standards to look for areas of misalignment; and
   - An inventory of issues requiring coordination is maintained by staff.

2. In Q3, 2020, the QM Chairs plan further coordination activity, which will focus on full alignment between the standards in preparation for the planned approval of the QM standards in September 2020.

3. The QM Task Forces continue to liaise with IESBA as needed. Topics discussed in Q2, 2020 include the objectivity of Engagement Quality Reviewers (see Agenda Item 8-A) and alignment between proposed ISA 220 (Revised) and IESBA’s role and mindset project.\(^3\) In Q3, 2020, additional IESBA coordination activities are planned for ISQM 1 and will be initiated for the other projects as needed.

Section II. Effective Date

Section II-A Background

4. The three QM exposure drafts (EDs) were accompanied by a covering explanatory memorandum. The covering memorandum set out the IAASB’s proposals regarding the effective date and the related implementation period for the three proposed standards, as well as the IAASB’s planned implementation support activities.

\(^1\) The QM standards are proposed ISQM 1, Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements; proposed ISQM 2, Engagement Quality Reviews; and proposed ISA 220 (Revised), Quality Management for an Audit of Financial Statements.

\(^2\) International Ethics Standards Board for Accountants

\(^3\) [www.ethicsboard.org/projects/role-and-mindset-expected-professional-accountants-formerly-professional-skepticism](http://www.ethicsboard.org/projects/role-and-mindset-expected-professional-accountants-formerly-professional-skepticism)
5. Question 1 from the covering memorandum asked:

   Do you support the approach and rationale for the proposed implementation period of approximately 18 months after the approval of the three standards by the Public Interest Oversight Board? If not, what is an appropriate implementation period?

6. At the time of the EDs being issued, an 18-month implementation period meant that the effective date of the QM standards would be approximately 15 December 2021.4

7. Respondents’ feedback on the effective date was presented to the IAASB in September 2019.5 A brief summary of the salient points are included in Appendix 1.

Section II-B  Wording of the Effective Date Paragraphs

8. The following wording is proposed for the QM standards:

<table>
<thead>
<tr>
<th>ISQM 1</th>
<th>ISQM 2</th>
<th>ISA 220 (Revised)</th>
</tr>
</thead>
</table>
   | Systems of quality management in compliance with this ISQM are required to be designed and implemented by [Date], and the evaluation of the system of quality management required by paragraph 65A of this ISQM is required to be performed within one year following [Date].6 | This ISQM is effective for:
   | a) Audits and reviews of financial statements for periods beginning on or after [Date]; and |
   | b) Other assurance or related services engagements beginning on or after [Date]. | This ISA is effective for audits of financial statements for periods beginning on or after [Date]. |

9. A slide presentation with voiceover has been prepared to illustrate how the effective dates work for different engagements (see Agenda Item 8-B).

The Meaning of the ISQM 1 Effective Date

10. The ISQM 1 TF considered the Board’s suggestion to clarify the meaning of “commenced operation” in the effective date. The ISQM 1 TF noted that the addition of “commenced operation” in the March 2020 draft of proposed ISQM 1 aimed to clarify that the operation of the firm’s responses and other various aspects of the system of quality management (SOQM) only need to commence on, or after, the effective date. The ISQM 1 TF is aware that there are a number of considerations for firms in terms of how they approach the implementation of the standard, and that adding further explanations of the meaning of “commenced operation” may complicate the description of the effective date.

11. As a result, the ISQM 1 TF is of the view that it is more appropriate to remove “commenced operation” and instead clarify the intended meaning of the effective date in the basis for conclusions and other supporting guidance. For example, the basis for conclusions and other supporting guidance could explain matters such as the following:

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4 At the time of the EDs, the approval of the QM standards was planned for March 2020 with public release of the final standards after the Public Interest Oversight Board approval of due process in June 2020.

5 See Agenda Item 5 of the September 2019 IAASB agenda material (https://www.iaasb.org/meetings/iaasb-board-meeting-new-york-usa-0)

6 The dates in ISQM 1’s effective date paragraph will be the same date.
In order for the system to be ready to commence operation by the effective date, the firm will need to establish the quality objectives, identify and assess quality risks and design and implement the responses by the effective date. The operation of the responses is only required to commence from the effective date.

The firm would be expected to design and implement the monitoring activities by the effective date, and the monitoring activities would commence operation from the effective date. The firm would also consider which monitoring activities that it currently performs under its existing system would need to be adapted to be appropriate for the new SOQM, or whether the monitoring activities would continue to exist under the new SOQM.

Practically, firms may take a number of approaches to implementing the standard. For example:

- Some firms may take a phased approach to implementing the standard by designing and implementing policies or procedures for certain components and commencing the operation of those policies or procedures at various stages before the effective date, in order to lessen the impact of the changes to the system. In such cases, the firm would establish the effective date of those policies or procedures. It is noted that in this situation, the firm would not have early adopted ISQM 1, since only a portion of the new system is coming into operation early. Other firms may only commence operation of all of their new policies or procedures as of the effective date.

- Some firms may determine it appropriate to pilot the new system prior to the effective date. The pilot may be on certain areas of the system, or the pilot may be undertaken by a selection of engagements teams. Piloting a new system ordinarily includes monitoring the effectiveness of the new system. As piloting is a “test” of the system, the SOQM would not be considered to be in operation until the firm has formally implemented and commenced operation of the new SOQM in its entirety.

The First Evaluation of the SOQM Following the Effective Date

12. In response to the Board’s suggestion in April 2020, the ISQM 1 TF has added specific clarification in the effective date that the evaluation of the SOQM needs to be performed within a year from the effective date.

13. The ISQM 1 TF considered how the first evaluation may be undertaken from a practical perspective in the first year, because the performance of engagements under the firm’s new policies or procedures and proposed ISA 220 (Revised), and the performance of the engagement quality reviews (EQR) under proposed ISQM 2 will take time to phase in. For example, assuming an effective date of December 15, 2022, engagements with a financial year end of June 30, 2023 will still be conducted under extant ISA 220, and the EQR will be performed under the extant requirements.

14. The ISQM 1 TF agreed that when the standard comes into effect firms would initiate their monitoring activities. The monitoring activities would need to comply with the requirements in ISQM 1, i.e., firms would be performing multiple monitoring activities of the SOQM as a whole and not only inspections of completed engagements. As a result, timely information should be coming through to the firm about the SOQM. Nevertheless, in the first year that the system operates, the information relating to engagements that may be used to evaluate the SOQM may be a combination of information arising from engagements performed under the extant standards and engagements performed under the new standards.
15. The information relating to engagements performed under the extant standards may be useful to the firm in identifying deficiencies and evaluating the SOQM. For example, findings related to engagements performed under the extant standards may be considered by the firm as follows:
   • How has the firm addressed this matter in their new SOQM?
   • Is the manner in which the firm addresses this matter in the new SOQM appropriate, taking into account the facts and circumstances of the finding? I.e., would the finding still have occurred if the new system had been applied?

Matter for IAASB Consideration
1. Does the IAASB support the wording of each of the effective date paragraphs in proposed ISQM 1, proposed ISQM 2 and proposed ISA 220 (Revised)?

Section II-C Consideration of the Options
16. Since the EDs were issued, the project timelines of the QM projects have changed for a number of reasons, and the final planned approval of the QM standards is now anticipated to be September 2020 (when the EDs were issued it was anticipated that the projects would have been approved in March 2020).

17. Furthermore, the QM Chairs have noted that the COVID-19 pandemic has a potential impact on implementation efforts as stakeholders have refocused their resources on dealing with the impact of COVID-19 and amending their policies and procedures in existing quality control measures. The QM Chairs decided that targeted outreach was needed to understand how COVID-19 could affect the effective dates of the QM standards. For example, documented processes may be amended to take account of social distancing and remote work requirements and planned implementation activities may be delayed. A summary of their feedback will be provided to the Board in June 2020.

18. Given the change in the project timelines, and the effect of the COVID-19 pandemic, the QM Chairs do not believe that an effective date of December 15, 2021 is viable. This is because:
   • There was significant disagreement with the implementation period proposed in the covering explanatory memorandum.
   • There will be insufficient time (approximately 12 months from the approval by the PIOB of the due process relating to the final standards) for firms to implement the standards in a manner that will achieve the public interest benefits that were envisioned by revising the QM standards.
   • Jurisdictions need sufficient time to adopt the standards in accordance with their local due process requirements, including translation of the standards (if required).
   • The effective date needs to be achievable for most jurisdictions so that the quality improvements can be driven globally. This may be particularly important for quality in firms that operate in multiple jurisdictions.

19. The options for the effective dates and the advantages and disadvantages of each are set out in the table below.
<table>
<thead>
<tr>
<th>Date</th>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
</table>
| 15 June 2022     | • Maintains proposed implementation period (i.e., 18 months) as proposed in the exposure drafts  
                  • Maintains urgency of the project | • Not supported by certain respondents across all stakeholder groups  
                  • A rushed implementation would not achieve the quality improvements the IAASB seeks from the project  
                  • Assumes best case scenario for the effects of COVID-19  
                  • Taking into account that engagement standards usually start in December (and both proposed ISQM 2 and proposed ISA 220 (Revised) are standards applicable to engagements), common financial statement periods, and firms’ training and development cycles into account, a December date is preferred |
| 15 December 2022 | • Responsive to respondents’ comments about the need for a longer implementation period  
                  • Maintains urgency of the project  
                  • Provides a more realistic scenario for the impact of COVID-19  
                  • Provides more time for the development of support materials  
                  • The above matters led to the conclusion that this is the earliest viable date | • Certain stakeholder may perceive a longer implementation period than was proposed in the ED to be inappropriate  
                  • Some stakeholders may still consider this insufficient time for effective implementation |
| 15 December 2023 | • Additional 12 months for firms to implement, which would allow for the most amount of time for implementation | • Lengthy wait until standards are effective is not in the public interest due to the delay in making important quality improvements  
                  • Longer implementation period than was sought by certain respondents |
Tentative Conclusions

20. The QM Chairs believe that the standards should have an effective date of 15 December 2022, as this appropriately balances the advantages and disadvantages of the different dates. In making this decision, the QM Chairs focused on:

- Maintaining the urgency of the reforms, and is responsive to the concerns of stakeholders that firms’ systems of quality management and the management of engagement quality is an area requiring improvement.
- Later dates inappropriately delay the needed quality improvements and may be perceived as extended the standard-setting processes unnecessarily.
- As noted in the exposure draft, a rushed implementation may exacerbate risks to quality, lead to increased inspection findings, and would be inconsistent with the objectives of the IAASB’s project to enhance its quality management standards.

21. Both alternative dates presented in the table were not supported by the QM Chairs because they presented challenges that are difficult to address. The Chairs also noted that an earlier date would raise significant concerns about a successful implementation and a later date would be seen as disregarding public interest concerns.

Section II-D Early Adoption

22. The covering memorandum to the QM exposure drafts noted at paragraph 26:

The IAASB proposes to allow early adoption; however, all three standards would need to be early adopted as a package due to the linkages between them and the incompatibility with extant standards that would result from selective early adoption of only one or two of the new standards.

23. The need for all the standards to be adopted as a package is because of the interrelationships between the standards. In particular, moving the EQR requirements from extant ISA 220\(^7\) to ISQM 1 and ISQM 2 results in the standards needing to be taken as a package to avoid a circumstance where no EQR provisions apply.

24. The QM Chairs considered whether early adoption of ISA 220 (Revised) or ISQM 2 (individually or together) would be possible. After extensive exploration of the possible options and implications, the QM Chairs concluded that early adoption of these standards would be impractical given the close links between the three standards and the risk of misapplication of the engagement quality review requirements (which are located in extant ISA 220 but are moving to ISQM 1 and ISQM 2).

25. The QM Chairs propose that, consistent with the EDs, early adoption of the package of standards be encouraged by the IAASB because it will allows implementation of the standards early if a firm is ready. The encouragement will be explained in the Basis for Conclusions and the first-time implementation support materials.

Matters for IAASB Consideration

2. Do you agree with the TF Chairs’ proposal that the effective dates for the QM standards should be December 15, 2022?

\(^7\) ISA 220, Quality Control for an Audit of Financial Statements
3. Do you agree that early adoption of the QM standards as a package should be encouraged?

Section III. Respondents’ Input on Possible Implementation Support Activities

26. Question 2 from the covering Explanatory Memorandum asked:

   In order to support implementation of the standards in accordance with the IAASB’s proposed effective date, what implementation materials would be most helpful, in particular for SMPs?

27. Respondents suggested various forms of implementation materials, including:
   - Illustrative examples - to illustrate the operation of particular requirements.
   - Frequently Asked Questions.
   - Illustrative documents (i.e. templates) that small- and medium-sized practices may use as a starting point to implementing their system of quality management.
   - Case studies - for different natures and circumstances to show how various components of the system of quality management work together.
   - The use of diagrams and flowcharts to clarify concepts within each standard and across the three quality management standards.

Agenda Item 8-C includes extracts from the comment letters in response to Question 2, together with respondents’ comments on the impact of the quality management standards for developing nations, the public sector, and translations.

28. Respondents also suggested that webinars or workshops would be helpful, as it would provide an opportunity for practitioners to ask relevant questions as they lead up to the implementation date, as well as share ideas.

29. Respondents also indicated that the Guide to Quality Control for Small- and Medium-Sized Practices was helpful and encouraged IAASB to work with IFAC’s SMP Committee (SMPC) to update the guide upon approval of the quality management standards.

Key Themes Related to Implementation Guidance Identified in Respondents’ Feedback on ISQM 1

30. Respondents suggested similar types of guidance as indicated above in their feedback on the various questions to ISQM 1. Furthermore, respondents indicated particular areas of ISQM 1 which would benefit from additional guidance, including:
   - Implementation of the firm’s risk assessment process.
   - Addressing the requirements in various fact patterns involving service providers.
   - How to perform root cause analysis.
   - Implementation of requirements over network requirements or network services.
   - Extent of documentation to demonstrate compliance with ISQM 1.

31. Given the respondent feedback the QM Chairs propose the following implementation support plan that is consistent with the plan used for ISA 315 (Revised 2019):
<table>
<thead>
<tr>
<th>Proposed Timing</th>
<th>Format</th>
</tr>
</thead>
</table>
| **First Time Implementation Guide**  
Highlighting significant changes in the published standard from extant standards | Fourth Quarter 2020 | Published document |
| **Fact Sheets**  
Short documents to provide focused implementation guidance to a specific topic. These may cover, for example:  
- Overall summary of the QM standards  
- The firm’s risk assessment process  
- Service providers  
- Networks requirements or network services  
- Dealing with impairment of the objectivity of an engagement quality reviewer | Fourth Quarter 2020 | Published document |
| **Staff Publication – Questions and Answers** | First Quarter 2021 | Published documents relating to matters not addressed in the First Time Implementation Guide or the Fact Sheets |
| **Webinar – Discussing Significant Changes in the Standards and Related Implementation Considerations** | First Quarter 2021 | Webinar |
| **Other Multimedia Assets** | Fourth Quarter 2020 | Voiceover animations (similar to what was done with the QM EDs). |

32. Of the other items mentioned by respondents, Staff do not believe that the IAASB should prepare illustrative templates or case studies. This is because such documents, issued by the IAASB, may take on greater authority than is intended and may result in firms failing to go through the necessary steps to design and implement the system of quality management in a manner that is truly tailored to their circumstances. This does not prevent other parties from offering such materials, because parties such as national standard-setters and professional accounting organizations may be closer to the nature and circumstances of particular categories of firms in a jurisdiction.

33. As part of the implementation support plan, and as noted by respondents, IAASB staff will encourage IFAC to update their *Guide to Quality Control for Small- and Medium-Sized Practices* and provide input as appropriate.

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8 Dates are subject to change, but implementation support activities will be complete by June 2021.
9 Other topics may be identified for the fact sheets or staff questions and answers.
Appendix 1

Summary of Comments on the Effective Date of the QM standards

[Note: Extracted from September 2019 IAASB agenda material and updated for additional comment letters]

Composition of Respondents

1. Seventy-six (76) comment letters were received from the following stakeholder groups:

<table>
<thead>
<tr>
<th>Stakeholder Group</th>
<th>Agree</th>
<th>Disagree</th>
<th>Agree but with further commentary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monitoring Group Members</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Investors and Analysts</td>
<td>3</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>Regulators and Audit Oversight Authorities</td>
<td>3</td>
<td>6</td>
<td>1</td>
</tr>
<tr>
<td>National Auditing Standard Setters</td>
<td>7</td>
<td>13</td>
<td>3</td>
</tr>
<tr>
<td>Accounting Firms</td>
<td>1</td>
<td>19</td>
<td>1</td>
</tr>
<tr>
<td>Public Sector Organizations</td>
<td>4</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>18</td>
<td>42</td>
<td>5</td>
</tr>
</tbody>
</table>

Note: some respondents did not address the implementation period.
What Alternative Implementation Dates Were Suggested?

3. Respondents also provided suggestions on alternative implementation periods. The table below summarizes the common themes in these suggestions. By way of explanation, a reference to, for example, 24 months, includes both respondents who would be satisfied with 24 months and those who wanted at least 24 months. Of the suggested implementation periods provided, at least 24 months was the most common.

<table>
<thead>
<tr>
<th>Stakeholder Group</th>
<th>24 months</th>
<th>30 months</th>
<th>36 months</th>
<th>Staged approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Monitoring Group Members</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>2. Regulators and Oversight Authorities</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>0</td>
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<tr>
<td>3. National Auditing Standard Setters</td>
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<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>4. Investors and Analysts</td>
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<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>5. Accounting Firms</td>
<td>8</td>
<td>1</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>6. Member Bodies and Other Professional Organizations</td>
<td>8</td>
<td>3</td>
<td>2</td>
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<tr>
<td>7. Public Sector Organizations</td>
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<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>22</strong></td>
<td><strong>4</strong></td>
<td><strong>2</strong></td>
<td><strong>3</strong></td>
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</tbody>
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