

EXTRACTS FROM THE DRAFT EXPOSURE DRAFT OF PROPOSED INTERNATIONAL STANDARD ON QUALITY CONTROL 1 (REVISED) – QUALITY MANAGEMENT FOR FIRMS THAT PERFORM AUDITS OR REVIEWS OF FINANCIAL STATEMENTS, OR OTHER ASSURANCE OR RELATED SERVICES ENGAGEMENTS

[MARKED FROM MARCH 2018 DRAFT]

Introduction

The Firm's System of Quality Management

- 2A. [Moved from paragraph 4] ~~The purpose of a system of quality management is to support the performance of quality engagements, in view of the firm's responsibility to act in the public interest, through~~The firm further promotes the public interest through establishing an environment, including a culture, decision-making process, actions, organization, leadership and resources ~~that promote compliance with the spirit of professional standards and applicable legal and regulatory requirements. that supports the performance of engagements in accordance with professional standards and applicable legal and regulatory requirements and judgments and conclusions that are appropriate.~~
3. [To be further considered in context of feedback from outreach and IESBA] When undertaking engagements, the firm and its personnel accepts their responsibility to act in the public interest. Acting in the public interest involves applying professional values, ethics and attitudes in making decisions that promote a commitment to quality, and take into consideration the legitimate interests of relevant stakeholders, in particular users of the firm's reports. The legitimate interests of relevant stakeholders may change over time and may change the manner in which the firm's engagements are performed.
- ~~4.~~ [Moved to paragraph 2A]
5. ~~The~~A firm's system of quality management is designed to provide the firm with reasonable assurance that the firm achieves ~~the~~its objectives set out in paragraphs 15(a) and (b). Professional judgment is applied in designing, implementing and operating a system of quality management that achieves such objectives. The nature and circumstances of the firm and the engagements it performs, including the types of entities for which such engagements are undertaken, are factors that are considered when applying professional judgment in order to make informed decisions about matters related to the firm's system of quality management. These factors may change over time, and therefore the firm maintains and updates the system in response to changes in such factors. (Ref: Para. A4)
6. The system of quality management is organized into the eight components described below. The components are connected because the system of quality management is a dynamic, iterative, and integrated process. A system of quality management is therefore not a linear process where one component affects only the next, but an integrated process in which all of the components may impact one another. The eight components are as follows—comprises the following eight components that operate in an integrated manner, which are further explained in paragraph 19: (Ref: Para. A2–A3)
- (a) The firm's quality risk assessment~~management~~ process;
 - (b) Governance and leadership;

- ~~(c) Information and communication;~~
- ~~(cd) Relevant ethical requirements;~~
- ~~(de) Acceptance and continuance of client relationships and specific engagements;~~
- ~~(ef) Resources;~~
- ~~(fg) Engagement performance;~~
- ~~(g) Information and communication; and~~
- (h) The monitoring and remediation process.

6A. ~~The firm's risk assessment process includes establishing quality objectives, which represent what needs to be achieved within the system of quality management such that the objectives in paragraph 15(a) and (b) are achieved. The quality objectives established by the firm are the quality objectives required by this ISQC, which are set out in each of the components, and if determined necessary to support the achievement of the objectives in paragraph 15(a) and (b), additional or more granular quality objectives. The firm's risk assessment process also includes the identification and assessment of quality risks to the achievement of the quality objectives, and the design and implementation of responses to address the quality risks. The firm is also required to include the responses required by this ISQC as part of the responses that are designed and implemented by the firm.~~

6B. ~~The firm is required to establish a monitoring and remediation process to evaluate the system of quality management as a whole. In doing so, the firm designs and implements monitoring activities over the firm's responses to quality risks and the firm's risk assessment process. The outcome of the firm's monitoring activities or other information may indicate that a quality objective or quality risk is inappropriate or missing. The firm uses the information obtained from the monitoring activities, the results of external inspections and any other relevant information to maintain and update the system.~~

~~6. Professional judgment in designing, implementing and operating the system of quality management is necessary for the establishment of a system of quality management that is designed to the nature and circumstances of the firm, the engagements it performs and the types of entities for whom such engagements are undertaken. Professional judgment involves applying relevant knowledge and experience to the facts and circumstances. (Ref: Para. A4)~~

7. ~~A further description of each of the eight components of the system of quality management and how they interrelate is included in Appendix 1.~~

~~Designing, implementing, and operating a system of quality management includes maintaining and updating the system to address:~~

- ~~• Changes in the nature and circumstances of the firm, the engagements performed by the firm and the types of entities for whom the engagements are undertaken; or~~
- ~~• The results of the firm's monitoring activities, external inspections or other relevant information.~~

Requirements

Applying, and Complying with, Relevant Requirements

18A. ~~The requirements are designed to enable the firm to achieve the objective stated in this ISQC. The proper application of the requirements is therefore expected to provide a sufficient basis for the~~

achievement of the objective of this standard. However, if the firm determines that the application of the requirements does not provide a sufficient basis for the achievement of the objective of this standard, the firm shall take further actions to support the achievement of the objective of this ISQC. Such actions shall include consideration of whether additional, or more granular, quality objectives than those required by this ISQC are necessary to support the achievement of the objective of this ISQC.

System of Quality Management

19. The firm shall design, implement and operate a system of quality management, in accordance with paragraphs ~~19A20~~ to 65, taking into consideration the nature and circumstances of the firm and the engagements performed by the firm, including the types of entities for which the engagements are undertaken, ~~which set forth the requirements regarding each of the eight inter-related components, such that the firm:~~ (Ref: Para. A16–A17)
- ~~(a) Establishes an environment, including a culture, decision-making process, actions, organization and leadership, that supports the design and operation of the other components of the system of quality management (governance and leadership);~~
 - ~~(b) Identifies risks to the achievement of quality objectives for each component of the system of quality management and assesses the risks as a basis for determining the responses to those risks (quality risk assessment process);~~
 - ~~(c) Obtains, generates or uses relevant information and communicates relevant information internally and externally on a timely basis to support the design, implementation and operation of the system of quality management (information and communication);~~
 - ~~(d) Manages compliance with relevant ethical requirements, in order that the firm, its personnel and others subject to relevant ethical requirements, as applicable (including network firm personnel), fulfill their respective responsibilities in respect of relevant ethical requirements (relevant ethical requirements);~~
 - ~~(e) Applies appropriate judgment when accepting or continuing client relationships and specific engagements (acceptance and continuance of client relationships and specific engagements);~~
 - ~~(f) Appropriately obtains, develops, uses, maintains and allocates financial resources, human resources, technological resources, and intellectual resources to support the design, implementation and operation of the system of quality management in a timely manner;~~
 - ~~(g) Appropriately performs and documents engagements in accordance with professional standards and legal and regulatory requirements, including making judgments and reaching conclusions that are appropriate; and~~
 - ~~(h) Evaluates the design, implementation and operation of the system of quality management.~~

Quality-The Firm's Risk Assessment Process [*Section moved - previously located after governance and leadership*]

24. ~~The firm shall apply the quality risk assessment process to the following components:~~
- ~~(a) Governance and leadership;~~
 - ~~(b) Information and communication;~~

- ~~(c) Relevant ethical requirements;~~
- ~~(d) Acceptance and continuance of client relationships and specific engagements;~~
- ~~(e) Resources; and~~
- ~~(g) Engagement performance.~~

~~25. In applying the quality risk assessment process, the firm shall: (Ref: Para. A38)~~

~~19A. The firm shall establish the quality objectives required by this ISQC and shall achieve the quality objectives through applying the requirements in paragraphs 19B–19D related to identifying and assessing quality risks and designing and implementing responses. The achievement of the quality objectives enable the firm to achieve the objective stated in this ISQC. (a) Establish quality objectives relevant to the nature and circumstances of the firm, the engagements performed by the firm and the types of entities for whom the engagements are undertaken, that are set at an appropriate level of granularity to enable the firm to identify and assess the quality risks (Ref: Para. A39)~~

~~19B. (b) As a basis for designing responses, The firm shall identify and assess the quality risks that have a reasonable possibility of occurring and which, individually or in combination with other quality risks, would cause a quality objective(s) not to be achieved if they were to occur through: (Ref: Para. A40–A42)~~

- ~~(ia) Understanding the conditions, events, circumstances, actions or inactions that may cause a quality objective not to be achieved, taking into consideration the nature and circumstances of the firm and the engagements it performs, including the types of entities for which such engagements are undertaken affect the achievement of the quality objectives in order to identify the quality risks; and~~
- ~~(bii) Assessing the likelihood of the quality risks identified in subparagraph (a) occurring, before consideration of any responses, and whether the relative effect of the identified quality risks would affect on the achievement of the quality objective(s), individually or in combination with other quality risks, if they were to occur.~~

~~19C.(e) The firm shall dDesign and implement responses to the assessed-identified quality risks. The responses shall:~~

- ~~(a) Appropriately address the nature of the quality risks and the likelihood of them occurring, including the particular characteristics of the conditions, events, circumstances, actions or inactions that give rise to the quality risks; and~~
- ~~(b) Include the responses that are required by this ISQC, adapted in a manner that is responsive to the nature of the quality risks identified by the firm and the likelihood of them occurring. (Ref: Para. A43–A47)~~

~~in order to reduce the quality risk to an acceptably low level. The nature, timing and extent of such responses shall be based on and be responsive to the reasons for the assessment given to the quality risks. (Ref: Para. A43–A47)~~

~~19D26. When The firm shall respond to changes in the nature and circumstances of the firm or, the engagements performed by the firm occur, including and the types of entities for which the engagements are undertaken, the firm shall by determin~~e~~ing whether the quality objectives, quality~~

risks and responses remain appropriate and if not, modifying them through applying the requirements in paragraphs 19A–19C as necessary. (Ref: Para. A48)

Governance and Leadership

~~Quality Objectives~~

20. The firm shall establish the following quality objectives, ~~in accordance with paragraph 25(a)~~, that address the aspects of the firm's environment that support the design, implementation and operation of the other components of the system of quality management, including the firm's culture, decision-making process, actions, organization and leadership. ~~In doing so, the firm shall include the following quality objectives:~~ (Ref: Para A18)

...

~~Quality Risks~~

- ~~21. The firm shall identify and assess the quality risks in relation to governance and leadership in accordance with paragraphs 25(b).~~

~~Responses to the Quality Risks~~

22. The firm shall identify and assess quality risks in relation to governance and leadership and design and implement responses in accordance with paragraph 25(c), to address the quality risks. in relation to governance and leadership. The responses that are designed and implemented by the firm responses designed and implemented by the firm shall include ~~shall include~~ the following responses:

...

Quality Risk Assessment Process [Section moved before governance and leadership]

Information and Communication [Section moved before monitoring and remediation]

Relevant Ethical Requirements

Acceptance and Continuance of Client Relationships and Specific Engagements

Resources

Engagement Performance

Information and Communication [Section moved – previously located before relevant ethical requirements]

Monitoring and Remediation Process

44. The firm shall establish the following quality objectives that address the firm's monitoring and remediation process that support the evaluation of the design, implementation and operation of the components of the system of quality management~~The firm shall establish a monitoring and~~

~~remediation process that evaluates the design, implementation and operation of the system of quality management, through:~~ (Ref: Para. A10)

- (a) ~~The firm's monitoring and remediation process provides relevant, reliable and timely information about the design, implementation and operation of the components of the system of quality management. Designing and performing activities to monitor the design, implementation and operation of the responses;~~
- ~~(b) Evaluating the findings of the monitoring activities, the results of external inspections and other relevant information; and~~
- (be) The firm takes appropriate actions to respond to identified deficiencies such that deficiencies are effectively remediated on a timely basis based on the results of internal monitoring activities, external inspections and other relevant information.
- (c) The firm's monitoring and remediation process provides information to the individual(s) assigned ultimate responsibility and accountability for the system of quality management sufficient to support their evaluation of whether the system of quality management provides the firm with reasonable assurance in relation to the matters described in paragraph 15(a) and (b).

~~*Designing and Performing Activities to Monitor the Design, Implementation and Operation of the Responses*~~

45. When the firm applies the firm's risk assessment process, the responses designed and implemented by the firm shall include the responses in paragraphs 45A–58 for monitoring and remediation.

Designing and Performing Monitoring Activities

45A. The firm shall determine the nature, scope and frequency of the monitoring activities, including the appropriate combination of ongoing and periodic monitoring activities. ~~In doing so, the firm shall take~~ing into consideration: (Ref: Para. A108–A110)

- (a) ~~In the case of a response that is being monitored, the design of the response and the assessment of the related quality risks, including and the design of the responses to the quality risks, including the the nature~~classes of engagements where quality risks are more likely to occur ~~or may result in a greater likelihood that a quality objective would not be met~~; (Ref: Para. A111)
- ~~(b) In the case of the firm's risk assessment process that is being monitored, the design of the firm's process to identify and assess quality risks and design and implement responses;~~
- (cb) Changes in factors that have affected the firm's system of quality management; (Ref: Para. A112)
- (de) The previous monitoring activities and remedial actions, including whether previous monitoring activities continue to be relevant in evaluating the firm's system of quality management; and (Ref: Para. A113)
- (ed) Other relevant information that may suggest deficiencies exist in the firm's system of quality management, including concerns identified regarding the commitment to quality of the firm or its personnel and information from external inspections. (Ref: Para. A113–A113a)

46. ~~As part of its monitoring activities, the firm shall establish policies or procedures requiring the inspection of completed engagements.~~The firm shall design and implement monitoring activities to determine whether the responses designed by the firm that are required to be implemented at the engagement level have been implemented. Such ~~policies or procedures~~ monitoring activities shall include inspection of completed engagements based on criteria established by the firm ~~establish criteria~~ that takes into consideration the factors ~~set out~~ in paragraph 45A ~~and which~~ and include the inspection of at least one completed engagement for each engagement partner on a cyclical basis determined by the firm. (Ref: Para. A114–A117)

46A. [Moved from 47(a)] ~~The firm shall establish policies or procedures that require~~ Determine that those performing the monitoring activities to have sufficient time and the competence, experience and knowledge ~~and sufficient time~~ to perform the monitoring activities effectively. ~~The policies or procedures shall also address the~~ and are objective in relation to the activity subject to monitoring of the individual performing the monitoring activity, and shall include requirements for the inspection of completed engagements that prohibit those performing the engagement or the engagement quality control review from being involved in the inspection; ~~and~~

Identifying and Evaluating the Deficiencies

47. The firm shall ~~perform the monitoring activities as designed~~. In doing so, the firm shall:

(a) ~~[Moved to 46A] Determine that those performing the monitoring activities have the competence, experience and knowledge and sufficient time to perform the monitoring activity and are objective in relation to the activity subject to monitoring; and~~

(b) ~~d~~ Determine whether the findings arising from the monitoring activities, the results of external inspections and any other relevant information indicate ~~a deficiency~~ ies, including a deficiency in the monitoring and remediation process. (Ref: Para. A118–A121)

48. ~~The firm shall determine whether the results of external inspections and any other relevant information include deficiencies.~~ (Ref: Para. A118–A121)

49. ~~The firm shall also evaluate the design, implementation and operation of the monitoring and remediation process, through considering the findings arising from the monitoring activities and the results of external inspections and any other relevant information and determining whether there are deficiencies in the monitoring and remediation process.~~ (Ref: Para. A122)

Root Cause Analysis and Evaluating the Deficiencies

50. The firm shall investigate the root cause(s) of the deficiencies, through performing procedures whose nature, timing and extent are based on the nature of the deficiencies and their possible severity, ~~and in doing so shall:~~ (Ref: Para. A123–A127)

(a) ~~Consider the nature of the deficiencies and their possible severity in determining the nature, timing and extent of the procedures to investigate the root cause;~~

(b) ~~Consider whether the deficiency is in the design, implementation or operation of a response;~~
and

50A. ~~(e)~~ The firm shall e Evaluate the effect of the deficiencies on the achievement of the quality objectives or the fulfillment of the requirements of this ISQC, through considering the severity and pervasiveness of the deficiencies.

Responding to Identified Deficiencies ~~Appropriately to the Results of Internal Monitoring Activities, External Inspections and Other Relevant Information~~

51. In circumstances when a deficiency identified relates to an engagement and there is an indication that the report may be inappropriate or that procedures required were omitted during the performance of the engagement, the firm shall: (Ref: Para. A128)
 - (a) Determine what further action is necessary to comply with relevant professional standards and applicable legal and regulatory requirements; and
 - (b) Consider whether to obtain legal advice.
52. The firm shall design and implement remedial actions to address the deficiencies ~~and their related root cause(s)~~ that are responsive to the results of the root cause analysis, including. ~~In doing so, the firm shall~~ determine ing whether the quality objectives, quality risks ~~and~~ responses remain appropriate. (Ref: Para. A129–A130)
53. The individual(s) assigned ultimate responsibility for the system or quality management or the individual assigned operational responsibility for the system of quality management, shall evaluate whether the remedial actions are appropriately designed to address the deficiencies and their related root cause(s) and determine whether they have been implemented. (Ref: Para. A131)

Ongoing Communication Related to Monitoring and Remediation

54. The individual(s) assigned operational responsibility ~~le~~ for the monitoring and remediation process shall communicate on a timely basis to the individual(s) assigned ultimate responsibility and accountability and the individual(s) assigned operational responsibility for the system of quality management: (Ref: Para. A132)
 - (a) A description of the monitoring activities performed;
 - (b) The deficiencies identified by the firm ~~through the findings from the firm's monitoring activities, the results of external inspections and other relevant information~~, including the severity and pervasiveness of such deficiencies; and
 - (c) The remedial actions to address the deficiencies, including the planned communication to firm personnel and parties that are external to the firm, as necessary.
55. The firm shall communicate the matters described in paragraph 54 ~~on a timely basis to firm personnel information in relation to the firm's monitoring and remediation process as described in paragraph 54 to the extent that it~~ is relevant to their responsibilities and enables the personnel. ~~The nature, timing and extent of the information communicated shall be sufficient to enable the firm personnel~~ to take prompt and appropriate action in accordance with their responsibilities. (Ref: Para. A133–A135)
56. The firm shall communicate information in relation to the results of the firm's monitoring and remediation process to external parties, on a timely basis, in accordance with paragraph 29(f).

Evaluating the Effectiveness of the System of Quality Management

57. The individual(s) assigned ultimate responsibility and accountability for the system of quality management shall evaluate whether the system of quality management provides the firm with reasonable assurance in relation to the matters described in accordance with paragraph 15 (a) and (b), taking into consideration:

- (a) The severity and pervasiveness of the deficiencies and whether they indicate that the firm has not fulfilled the requirements of this ISQC 1;
- (b) The conclusions in paragraph 53 regarding whether the remedial actions are appropriately designed to address the deficiencies and their related root cause(s), and have been implemented; and
- (c) Whether there has been appropriate communication of matters related to monitoring and remediation internally and with external parties.

The evaluation shall be performed at least annually and when the effect of the deficiencies are of a severity and pervasiveness that there is an indication that the system may not be providing the firm with such reasonable assurance. (Ref: Para. A137)

- ~~(a) On an annual basis; or~~
- ~~(b) In circumstances when the deficiencies identified are of a severity and pervasiveness that indicate that the system may not be providing the firm reasonable assurance.~~

58. ~~In circumstances when~~If the firm's evaluation described in paragraph 57 indicates that the firm does has not have achieved reasonable assurance in accordance with paragraph 15, the individual(s) assigned ultimate responsibility and accountability for the system of quality management shall take prompt and appropriate action in accordance with their responsibilities, firm shall: (Ref: Para. A138)

- ~~(a) Promptly including communicating this facte to firm personnel information to the extent that it is relevant to their responsibilities. (Ref: Para. A138) about the deficiency(ies) and the remedial actions to be taken; and~~
- ~~(b) If appropriate, communicate relevant information about the firm's evaluation to parties that are external to the firm.~~

Considerations ~~Relating to~~for Networks

Considerations ~~Relating to~~for Use of Service Providers

Documentation