



July 1, 2019

Mr. Willie Botha  
Technical Director  
International Auditing and Assurance Standards Board  
529 Fifth Avenue  
New York, NY 10017

**Re: The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level, Including Engagement Quality Reviews**

Dear Mr. Botha:

The American Institute of Certified Public Accountants (AICPA) Auditing Standards Board (ASB) is pleased to respond to the International Auditing and Assurance Standards Board's (IAASB) Exposure Draft, International Standard on Quality Management 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements* (the "Exposure Draft" or "ED-ISQM 1"), Proposed International Standard on Quality Management 2, *Engagement Quality Reviews* ("ED-ISQM 2") and Proposed International Standard on Auditing 220 (Revised), *Quality for an Audit of Financial Statements* ("ED-220"), (collectively the "Proposed Standards").

The AICPA is the world's largest member association representing the accounting profession, with more than 657,000 members in 143 countries and a history of serving the public interest since 1887. AICPA members represent many areas of practice, including business and industry, public practice, government, education, and consulting. Among other things, the ASB sets U.S. quality control standards (Statements on Quality Control Standards [SQCSs]); auditing standards (Statements on Auditing Standards [SASs]); and attestation standards (Statements on Standards for Attestation Engagements [SSAEs]), for private companies, nonprofit organizations, and federal, state and local governments (nonissuers).

We are supportive of the IAASB's project to improve the quality of engagements through addressing key public interest issues related to the management of quality at a firm and engagement level and the performance of engagement quality reviews. We support the risk-assessment approach to quality management and believe that the Proposed Standards are by and large scalable to firms of different sizes and complexities. We have been closely monitoring this project and note that the ASB is targeting 2020 for an exposure draft of proposed changes to the AICPA's SQCs.

As described above, the ASB sets standards for audits of nonissuers. In the U.S. many of our members and their firms are also subject to quality controls standards established by the U.S. Public Company Accounting Oversight Board (PCAOB) for audits of listed companies and other entities considered as issuers. We understand that the PCAOB is also engaged in research with respect to potential standard-setting related to quality control standards. As the IAASB seeks to finalize its risk-assessment approach to quality management, we strongly encourage that the IAASB work closely with the PCAOB so that the fundamental concepts and objectives of a firm's approach to quality management/control are aligned.

Our views in this letter are organized into the following sections:

- I. Comments on the Overall Explanatory Memorandum



- II. Comments on ED-ISQM 1
- III. Comments on ED-ISQM 2
- IV. Comments on ED-220

Note that we have used ***bold italics*** to indicate proposed additions to text and ~~strikethrough~~ to indicate deletions.

## **I. Comments on the Overall Explanatory Memorandum**

### **General Comments on the Overall Explanatory Memorandum**

We are generally supportive of the Proposed Standards. However, we believe that implementation of the Proposed Standards will be challenging for many, if not most, firms. Two things are essential for firms to be able to meet that challenge: sufficient time and implementation support. We believe that appropriately addressing these critical areas is of paramount importance to meeting the objectives of the IAASB's project to enhance the quality of engagements.

### ***Overall Questions***

- 1) 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?

It is not clear to us whether establishing a system of quality management in accordance with ED-ISQM 1 would require that the system be tested, monitored, and documented by the effective date, or if the system need only be designed and implemented by the effective date. If the system need only be designed and implemented by the effective date and monitoring the effectiveness and making revisions to processes and related documentation need not be completed by the effective date, it would be helpful to make that explicit so that firms, regulators and other stakeholders have a common understanding.

We do **not** believe that 18 months from approval of the three standards by the Public Interest Oversight Board (PIOB) is enough time to allow firms to understand, design, implement, document, and train personnel on the new approach to quality management. We agree with the rationale for an appropriately long implementation period stated in paragraph 24 of the IAASB's Covering Explanatory Memorandum. We also agree, as stated in paragraph 25 of the Overall Explanatory Memo, that "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."

We believe that 18 months will result in a rushed and ineffective implementation for firms of all sizes and compositions, even for those firms that have already invested significant resources in quality control processes. Depending on the timing of final approval of the Proposed Standards and a firm's practice, 18 months may encompass one "busy season" for some firms but two "busy seasons" for others.

An implementation period that allows enough time to effectively implement the Proposed Standards is essential in order to achieve the improvements in engagement quality, which is in the public interest. "Getting it right the first time" is key and that requires time. Implementation of the Proposed Standards will require firms to do the following:

- Perform the analysis necessary to determine the systemic changes needed to comply with the Proposed Standards
- Make the necessary organizational changes which, for many firms, will require the addition of additional resources,
- Design, implement, and document the risk assessment approach,
- Design, implement, and document the information and communication requirements,
- Design, implement, and document an enhanced monitoring and remediation process, and
- Design, implement, and document the effectiveness of the overall evaluation of the system of quality management. This requirement in particular will require time for firms to test new processes to ensure the system is operating effectively.

We applaud the IAASB for taking the time necessary to:

- consult publicly and research,
- develop a project proposal,
- draft and debate the Proposed Standards, including allowing five months for exposure, and
- ultimately, get the Proposed Standards right.

We ask that the IAASB provide firms the time necessary to implement the Proposed Standards. Having firms use the risk-based quality management approach in accordance with the Proposed Standards as soon as practicable is in the public interest. We believe that “as soon as practicable” is at minimum an implementation period of 24 months for firms to design, implement, and begin to document of the new approach to quality management. As described above, it should be clear that firms would use the periods after the effective date for monitoring and revising the system, as appropriate. We believe the 24-month period and clarity with respect to implementation approach is necessary for the intended benefits of the Proposed Standards to be achieved, and not create potential unintended consequences related to audit quality.

2) 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?

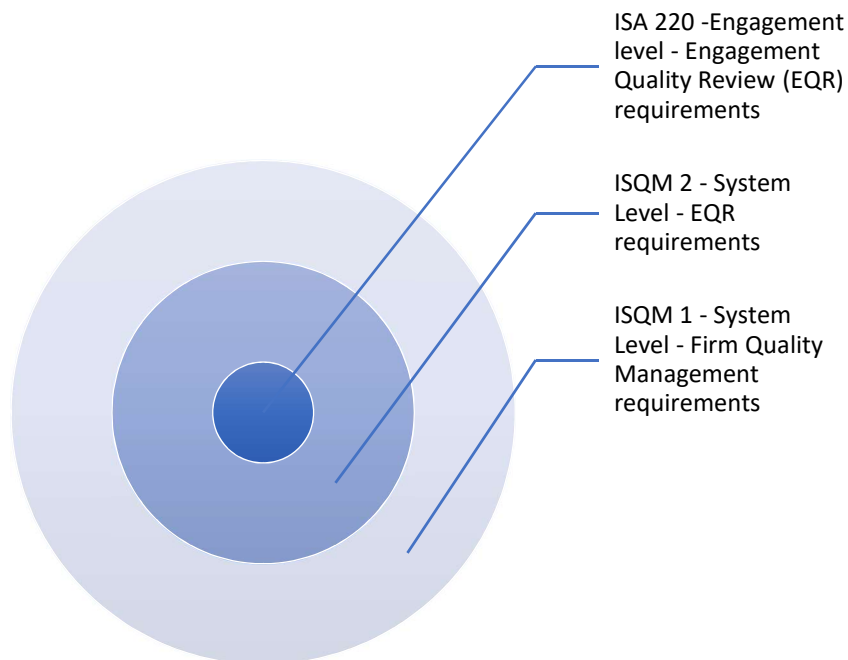
Equally essential to the effective implementation of the Proposed Standards as an appropriately long implementation period is the availability of implementation support materials when the Proposed Standards are issued. We are concerned that many firms will delay starting their implementation efforts until such materials are made available, thus negating portions of the implementation period if such guidance is not available when the Proposed Standards are issued. We applaud the IAASB for planning to develop materials to accompany the Proposed Standards, when finalized, to facilitate a proper understanding of the standards. The IAASB has provided an impressive number of resources explaining what the Proposed Standards require: four explanatory memos, six hours of webcasts, and videos on its website. As described in more detail below, we recommend that the IAASB’s excellent work in developing materials to accompany the Proposed Standards be further enhanced through the creation of additional non-authoritative illustrative tools and further development of its current FAQ document. Such implementation support materials will continue to be useful once the Proposed Standards are effective, to assist firms in maintaining and continuously improving their system of quality management.

Implementation support materials could be provided in the following ways:

*Overview of the Proposed Standards (Executive Summary)*

The Explanatory Memorandums in the Exposure Drafts present an excellent high-level overview of the Proposed Standards. They also explain the IAASB's thought process behind the requirements, and the wording of the requirements. We found the graphics in the explanatory memorandums helpful. Accordingly, we recommend that when the Proposed Standards are approved, the Explanatory Memorandums, appropriately updated, be issued as implementation support material, perhaps in a document akin to the Executive Summary included in the four-part Committee of Sponsoring Organizations of the Treadway Commission (COSO) Integrated Framework (2013) (the "COSO Framework").

We further suggest that a graphic such as the following be included in this overview to explain the relationship between the three Proposed Standards.



### *Illustrative Tools*

Because quality risks and responses are dependent on the facts and circumstances of each firm, we believe the most useful implementation support materials would provide focus on the thought process for proper implementation. Understanding the answers to the following questions will help firms overcome the most challenging aspects of adopting the Proposed Standards:

- Why were these particular quality objectives chosen?
- How should firms think about risks (nature, timing and extent of documentation of risk assessment processes would seem to be an area where inconsistent understanding and application could occur)?
- How are appropriate responses developed and documented?
- What are the most effective and efficient ways to measure and monitor the successful implementation of the Proposed Standards?



Materials such as case studies, practice aids, and webinars that provide best practices and other considerations regarding applying the quality management process would be helpful. Additional illustrative tools could be similar to those provided in the four-part COSO Framework, *Illustrative Tools for Assessing Effectiveness of a System of Internal Control*.

We found the current Draft Examples<sup>1</sup> confusing. For instance, the likelihood of occurrence of the quality risks seems to be assessed twice. This appears to result in a ranking of the risks, which is not required by the Proposed Standards. The examples do not demonstrate how to correlate the risk, the ranking of the risk, and the response. We note that example 2 focuses on only one sub-objective and identifies three quality risks “among the quality risks identified”. This example is quite long. Extrapolating to the entire system of quality management could and probably would be interpreted to indicate that firms should produce hundreds of pages of detailed documentation. This may not be an accurate representation of what is required for all firms and may overwhelm a firm as they attempt to implement the Proposed Standard. However, we recognize the draft nature of this example and encourage the IAASB’s further development of examples further demonstrating the intended scalability and application of the standards.

We urge the IAASB to work with National Standard-setters (NSS) to identify areas where additional implementation support material may be needed. In addition, the IAASB is well-positioned to facilitate coordination and sharing of resources among NSS.

We also encourage the IAASB to reach out to large network firms to understand implementation issues that may be arising and to develop non-authoritative guidance including examples relating to firm networks and affiliations.

Finally, we believe that implementation support material aimed at helping regulators gain a consistent understanding of the Proposed Standards would be extremely helpful. Clearly stating that the Illustrative Tools are additional references or resources that are not part of the Proposed Standards, but merely practical approaches and examples illustrating application, would be important in this regard.

### *Frequently Asked Questions*

We found the draft Frequently Asked Questions (FAQs) helpful. We encourage the IAASB to consider the comments received on the Proposed Standard and expand the FAQ document based on additional insights received. We find that the FAQ format is incredibly helpful to practitioners and is a useful mechanism for the IAASB to provide additional insight into the thought process and intent behind the written words of the standards.

### **General Questions**

Public Sector—The IAASB welcomes input from public sector auditors on how the proposed standards affect engagements in the public sector, particularly regarding whether there are potential concerns about the applicability of the proposals to the structure and governance arrangements of public sector auditors.

We believe that the Proposed Standards appropriately address public sector auditors. A significant number of engagements that occur in the U.S public sector are performed by small government audit

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<sup>1</sup> Draft Examples: How the Nature and Circumstances of the Firm and the Engagements It Performs Affect the Implementation of Proposed ISQM 1.



organizations and other small- and medium-sized practitioners (“SMPs”), so implementation support materials for SMPs that includes public sector considerations would be helpful.

## II. Comments on ED-ISQM 1

### ***General Comments on Proposed ISQM 1***

We are supportive of the IAASB’s project to improve the quality of engagements through addressing key public interest issues related to the management of quality at a firm and engagement level and the performance of engagement quality reviews. We support the risk-assessment approach to quality management and believe that the Proposed Standards are by and large scalable to firms of different sizes and complexities. However, we believe that implementation of the Proposed Standards will be challenging for many, if not most, firms. Two things are essential for firms to be able to meet that challenge: sufficient time and implementation support. We believe that appropriately addressing these critical areas is of paramount importance to meeting the objectives of the IAASB’s project to enhance the quality of engagements.

### ***ISQM 1 Overall Questions***

1. Does ED-ISQM 1 substantively enhance firms’ management of engagement quality, and at the same time improve the scalability of the standard?

We believe that ED-ISQM 1 has the potential to substantively enhance firms’ management of engagement quality and improve the scalability of the standard. Implementation support materials will be essential in order to for firms to achieve that potential.

- (a) Do you support the new quality management approach? If not, what specific attributes of this approach do you not support and why?

We support the change from quality control to quality management, as it emphasizes the need to manage quality rather than to control quality. We believe the proposed standards provide an opportunity for firms to evaluate their existing quality control systems in the context of the risk assessment approach. This will allow firms to identify those areas already operating effectively and those areas where enhancements to controls and documentation are needed. We believe this will improve quality.

However, we cannot overemphasize the need for a long enough implementation period and development of implementation support materials in order to achieve the potential of ED-ISQM 1.

- (b) In your view, will the proposals generate benefits for engagement quality as intended, including supporting the appropriate exercise of professional skepticism at the engagement level? If not, what further actions should the IAASB take to improve the standard?

We believe that ED-ISQM 1, if implemented as intended, will generate benefits for engagement quality. We believe that professional skepticism is appropriately addressed in ED-ISQM 1, at a firm level, and with greater focus on engagement performance in ED-ISQM 2 and ED-ISA 220.

- (c) Are the requirements and application material of proposed ED-ISQM 1 scalable such that they can be applied by firms of varying size, complexity and circumstances? If not, what further actions should the IAASB take to improve the scalability of the standard?

The approach of identifying and responding to a firm's specific risks rather than only requiring prescribed responses is inherently scalable. Scalable standards make clear to firms what is necessary to apply principles-based requirement so that they can do so effectively and efficiently without actions or documentation that might appear to be required but are not necessary in the circumstances of the audit.

We generally agree that the requirements and application material in ED-ISQM 1 address scalability, however, there is a possibility that application material explaining that certain requirements may not apply to smaller firms will be misinterpreted as "much of this doesn't apply to small firms". More examples that illustrate how straightforward it may be for a smaller firm to apply a particular requirement would be helpful and are probably necessary. We have noted above areas where we think scalability will be more challenging.

As discussed above, we believe the largest risk to scalability resides squarely in the implementation of the Proposed Standards. Although the requirements in the Proposed Standards are principles-based and allow for scalability, how firms are evaluated on the implementation or how much emphasis is placed on firms having similar systems of quality management could work against the scalability of the Proposed Standard. Again, implementation support materials demonstrating the scalability of the Proposed Standard are essential.

2. Are there any aspects of the standard that may create challenges for implementation? If so, are there particular enhancements to the standard or support materials that would assist in addressing these challenges?

We perceive two significant areas as particularly challenging: assessing risk and developing appropriate responses, as well as determining the nature, timing and extent of testing and documentation.

Identifying and assessing the firm's quality risks is the essence of this standard and will be a challenge for many firms. Risk assessment, in general, is difficult even for experienced practitioners. This was demonstrated with the adoption of the COSO Framework for both private and public companies and the adoption of reporting on internal control over financial reporting required by the Sarbanes-Oxley Act (SOX) for public companies. It is also obvious in reviewing the results of the AICPA Peer Reviews and regulator inspections of public accounting practices. Therefore, it is important that firms understand why the quality objectives in ED-ISQM 1 were chosen, how they should think about quality risks, and how to develop appropriate responses. Because quality risks and responses are dependent on the facts and circumstances of each firm, we believe the most useful implementation support would provide focus on the thought process for identification of quality risks and development of appropriate responses. Materials such as webinars or practice aids explaining best practices in quality management process application and other quality management considerations would be helpful. Further, support material should explain the risk assessment process as thoroughly as possible, in clear, simple language. Support material that addresses the differences in assessing risks for different types of service would also be helpful.

Implementation support material providing examples of documentation and training on how to test a system of quality management would be very helpful, particularly to SMPs.



Other aspects of the standard that we believe present implementation challenges are discussed below, including

- establishing additional quality objectives (see question 6(b)iii)
- identifying entities of significant public interest, and determining whether an engagement quality review may not be an appropriate response for an audit of such an entity (see question 11)

3. Is the application material in ED-ISQM 1 helpful in supporting a consistent understanding of the requirements? Are there areas where additional examples or explanations would be helpful or where the application material could be reduced?

We found the application material helpful, particularly the examples. We believe more examples that focus specifically on the risk assessment process would be useful. However, it is important to strike the right balance between providing enough examples and application material to ensure consistency in the application of the proposed standard while diminishing the unintended consequences of stakeholders' expectations that examples are de facto requirements.

We find the application material for engagement performance equally applicable to intellectual resources; this is an example of the interrelationship between components that could be provided in implementation guidance.

Suggestions for areas where additional explanations or non-authoritative examples and illustrative tools would be helpful are included in answers to the other questions.

### **Specific Questions**

4. Do you support the eight components and the structure of ED-ISQM 1?

We support the identified eight components and the ED-ISQM 1 structure.

An explanation, in application guidance in ED-ISQM 1, of why the Governance and Leadership component is placed before the Firm's Risk Assessment Process would be helpful. We do not disagree with the structure, but it was an item that we discussed with differing viewpoints expressed. Our understanding is that differing viewpoints were also expressed by the IAASB while drafting ED-ISQM 1. Providing insight into the rationale for the placement of the Governance and Leadership component before the Firm's Risk Assessment Process would assist practitioners in understanding the philosophy as they implement ED-ISQM 1. For example, application material might state that "Governance and Leadership are prerequisites for effective implementation of all other components."

Paragraph A5 states that the firm may use different terminology or frameworks to describe the components of its system of quality management. Assuming that "different" means "other than that used in this standard", it is not clear what other framework could be used because it is not clear what framework is used in ED-ISQM 1. We believe the intent to be how the firm organizes its components. We also believe it is important to state that all components need to be addressed in the system of quality management, regardless of the terminology. We suggest the following revision:

The firm may use different terminology or frameworks to describe the components of its system of quality management, **provided all components in this ISQM are addressed.**

Appendix 1 to ED-ISQM 1 describes the components of a system of quality management. It is not clear what the purpose is of this appendix or who its intended users are. It does not explain the interrelationship among the components. This could easily form the basis for support material, which could include the



graphics included in the Explanatory Memorandum. However, we do not believe that it should be included as an appendix to the standard.

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

We support the objective of the standard; however, we believe that the related explanations in the standard can be improved.

The relationship between the objective of the firm and the objective of the system of quality management is very clearly explained in paragraphs 16-18 of the Explanatory Memorandum but is not explained in the standard. We suggest the following revision to paragraph 7 of ED-ISQM 1 to incorporate this explanation:

Paragraph 7 ***The objective of the firm, as stated in paragraph 18, is to design, implement and operate a system of quality management.*** ~~The purpose of a system of quality management is~~ ***designed*** to support the consistent performance of quality engagements, by ~~providing~~ ***provide*** the firm with reasonable assurance that the objectives of the system, stated in paragraph 18(a) and (b), are achieved. The ***objectives of the system of quality management support the consistent performance of quality engagements, which serves the*** public interest ~~is served by the consistent performance of quality engagements.~~ Quality engagements are achieved through planning and performing engagements and reporting on them in accordance with professional standards and applicable legal and regulatory requirements. Achieving the objectives of those standards and complying with the requirements of applicable law or regulation involves exercising professional judgment and, when applicable to the type of engagement, exercising professional skepticism. (Ref: Para. A2-A4)

6. Do you believe that application of a risk assessment process will drive firms to establish appropriate quality objectives, quality risks and responses, such that the objective of the standard is achieved?

We believe the proposed risk assessment process can be effective, however as noted, only if enough implementation support materials are provided.

In particular:

- (a) Do you agree that the firm's risk assessment process should be applied to the other components of the system of quality management?

We agree the firm's risk assessment process should be applied to the other components of the system of quality management.

- (b) Do you support the approach for establishing quality objectives?

- i. Are the required quality objectives appropriate?

We believe that the required quality objectives are appropriate. [See specific comments on certain quality objectives in “Paragraph-level comments” below].

ii. Is it clear that the firm is expected to establish additional quality objectives beyond those required by the standard in certain circumstances?

While we believe it is clear that the firm is expected to establish additional quality objectives beyond those required by the standard when those objectives are necessary to achieve the objective of this ISQM., we are concerned that including such a statement as a requirement may result in an expectation that the firm will need to consider and document their conclusion that “no additional objectives were identified”. We are concerned that this could negatively impact the scalability of the standard, particularly for SMPs. We suggest the IAASB consider how this is positioned and suggest the following as a starting point:

26. The firm shall establish the quality objectives required by this ISQM. The firm shall also **consider whether** ~~establish~~ additional quality objectives beyond those required in this ISQM, ~~when those objectives are necessary to achieve the objective of this ISQM, and~~ **if so, establish those additional quality objectives.** (Ref: Para. A48-51)

Additionally, it is not at all clear what factors a firm would considered to determine when additional objectives would be necessary, nor what those additional quality objectives, might be. The IAASB has not provided any examples of factors that would indicate the existence of circumstances requiring additional quality objectives or of any additional quality objectives that might exist. Such examples would be helpful; we have not been able to identify any. The proposed standard is also unclear about whether firms are routinely required to perform an evaluation to attempt to identify additional quality objectives or whether this requirement should be applied when a firm, while implementing the required quality objectives, identifies a gap in the system of quality management indicating the need for an additional quality objective to be established. Accordingly, we believe paragraph A49 should be revised as follows:

A49. The quality objectives that the firm is required to establish are set out in paragraphs 23, 32, 34, 36, 38, 40 and 42. In addition, given the nature and circumstances of the firm and its engagements, the firm:

- ~~is~~ **may be** required to establish additional quality objectives beyond those required by this ISQM, ~~when those~~ **the implementation of the required** quality objectives ~~are necessary to~~ **does not** achieve the objective of this ISQM.
- ~~May~~ **may** decide that more granular quality objectives than those set out in this ISQM are appropriate. Establishing more granular quality objectives may enhance the firm’s identification and assessment of quality risks.

(c) Do you support the process for the identification and assessment of quality risks?

In general, we support the process for the identification and assessment of quality risks. However, effective risk assessment is difficult, and firms will need implementation support, including enough time and guidance materials.

We are concerned that the process required by paragraphs 27-29 of ED-ISQM 1 is not clear as to whether quality risks are all risks or only those risks that are reasonably possible and would have a



significant effect. Notwithstanding that *quality risk* is a defined term, we suggest that paragraphs 27-28 be revised as follows:

27. The firm shall understand the conditions, events, circumstances, actions or inactions that may adversely affect the achievement of its quality objectives, taking into account the nature and circumstances of the firm and its engagements, ~~to provide the basis for the identification and assessment of quality risks.~~ (Ref: Para. A48, A52)

28. Based on the understanding obtained in paragraph 27, the firm shall identify those quality risks **(that is, those risks arising from conditions, events, circumstances, actions or inactions that may adversely affect the achievement of a quality objective(s))** that, before consideration of any responses: (Ref: Para. A48, A53–A54)

(a) Have a reasonable possibility of occurring; and (Ref: Para. A55)

(b) If they were to occur, may individually or in combination with other quality risks, have a significant effect on the achievement of a quality objective(s). (Ref: Para. A56–A57)

The distinction between the identification of quality risks in paragraph 28 and the assessment of quality risks in paragraph 29 is not clear. Paragraph 33 of the Explanatory Memorandum to ED-ISQM 1 explains the identification and assessment of quality risks as a two-step process: paragraph 28 being a *preliminary consideration*, and paragraph 29 being a *more detailed consideration*. The Explanatory Memorandum further states that “in some instances, the two steps may be undertaken concurrently by the firm.” These explanations are helpful and should be included in ED-ISQM 1.

Paragraph A55 only addresses likelihood. We suggest that paragraph A55 be combined with paragraph A57 to reinforce that quality risks are assessed both for likelihood and magnitude. We note that likelihood and magnitude are the terms used in other standards. Consistency among standards aids adoption.

Because we are not clear as to what is meant by the term “significant effect” in the context of risks and are concerned that it may be analogized to “significant risks” as used in the ISAs, we suggest that paragraph 28(b) be revised as follows:

(b) If they were to occur, may **result**, individually or in combination with other quality risks, ~~have a significant effect on the achievement of~~ **in** a quality objective(s) **not being achieved**.

Guidance is needed about the degree of specificity that would be appropriate in documentation with regard to the requirements in paragraphs 27 and 28, so that firms do not think they need to document every condition, event, circumstance, action or inaction that may adversely affect the achievement of its quality objectives, no matter how insignificant.

(d) Do you support the approach that requires the firm to design and implement responses to address the assessed quality risks?

We support this approach.

i. Do you believe that this approach will result in a firm designing and implementing responses that are tailored to and appropriately address the assessed quality risks?



We believe this has the potential for firms to appropriately address the assessed quality risks; however, we are concerned that firms will not perform the assessment as the IAASB intends for it be performed.

Peer reviews performed on non-listed entities in the United States show that many firms currently believe that they have appropriately responded to the requirements of ISQC 1 by using third-party practice aids without having tailored those practice aids to the nature and circumstances of their firm. This indicates that many firms will struggle with designing and implementing responses that are tailored to, and appropriately address, their assessed quality risks. Enough implementation time and implementation support materials will help provide firms with the opportunity to evaluate their processes and obtain the resources necessary to successfully achieve the objectives of the Proposed Standards.

ii. Is it clear that in all circumstances the firm is expected to design and implement responses in addition to those required by the standard?

Paragraph A59 is very clear, but we believe that this needs to be explicitly stated in the requirements section. In addition, the requirement in paragraph 29 to assess the quality risks identified in paragraph 28 to provide a basis for the design and implementation of the related responses and the requirement in paragraph 30 that the design of the responses shall be based on, and responsive to, the reasons for the assessments given to the quality risks, are redundant. We propose that paragraphs 29 and 30 be revised as follows:

29. The firm shall assess the quality risks identified in paragraph 28 **and, based on that assessment, to provide a basis for the design and implementation of the related responses.** (Ref: Para. A48, A58)

~~30. The firm shall design and implement responses to address the assessed quality risks, including responses required by this ISQM. The design of the responses shall be based on, and responsive to, the reasons for the assessments given to the quality risks. (Ref: Para. A48, A58A59–A64)~~

In addition, paragraphs 24, 30, 33, 35, 37, 39, and 41 should be conformed to the following template:

~~In designing and implementing responses to~~ **To** address the quality risks identified and assessed by the firm relating to the [component name] quality objectives, the firm shall **design and implement responses that** include, **but are not limited to**, the following responses:

Further explanation would be helpful, perhaps in paragraph 10c, of why required responses are not always included (for example, responses that are repetitive of the related objective were not included for conciseness). It would also be helpful to include in application material that paragraph 10c uses “will be needed” rather than “may be needed, because it is not possible to comprehensively address all of the responses needed by firms in the standard, given the varying nature and circumstances of firms and the engagements they perform.

It is not explicit in the standard that one response can address quality risks in different components. We believe it would be helpful to add application guidance to state this explicitly.

7. Do the revisions to the standard appropriately address firm governance and the responsibilities of firm leadership? If not, what further enhancements are needed?



Yes. However, many SMPs will need to develop more formal documentation about this component, which will take time and require implementation support.

**8. With respect to matters regarding relevant ethical requirements:**

- (a) Should ED-ISQM 1 require firms to assign responsibility for relevant ethical requirements to an individual in the firm? If so, should the firm also be required to assign responsibility for compliance with independence requirements to an individual?

We support the requirements in ED-ISQM 1 regarding relevant ethical requirements. We do not support a requirement for firms to assign operational responsibility for relevant ethical requirements to an individual in the firm. We believe that the structure of responsibility in the Governance and Leadership component provided in paragraph 24 is sufficiently flexible to allow firms to assign operational responsibility for various components or other aspects of the system as appropriate for their firm's needs, and we do not believe the Relevant Ethical Requirements component should be treated differently. In addition, it is not clear what the criteria for appointing this individual would be and what this individual's responsibility would entail. Would this person be responsible for overseeing the firm's responses as prescribed by paragraph 33 of ED-ISQM 1? If so, that would be akin to requiring that every firm have an ethics officer, which we believe is beyond the scope of what a principles-based standard should require. We are concerned that such a requirement could be interpreted as that individual being responsible for the compliance with relevant ethical requirements of the firm as a whole and of each individual person within the firm, which may not be practicable.

While we believe that the question of whether to require firms to assign responsibility for compliance with independence requirements stands on its own, and that many firms currently do so, we believe that such a requirement would be overly prescriptive and should not be included.

- (b) Does the standard appropriately address the responsibilities of the firm regarding the independence of other firms or persons within the network?

Yes, however it may be helpful to note in paragraph 14 that requirements that pertain to networks are not limited to those in paragraphs 58-63 and related application material in paragraphs A192-A204. For example, independence with regard to networks is addressed in paragraph A71.

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

Yes. We see this as an area for further guidance and outreach, perhaps as part of implementation support and implementation review processes as firms adopt and experiment with new technologies in delivering audit and attest services.

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

We believe that, in general, the requirements will promote improved communication; however, we are concerned that the reference to transparency reports in paragraph 41(c)(iv) will lead firms and regulators to believe that transparency reporting is implicitly required by the standard, regardless of the inclusion of the words “when the firm determines it appropriate to do so”. In addition, it can be inferred that firms will be expected to provide information to anyone who may use it. This inference is strengthened by including guidance for making this determination in paragraphs 41(c)(iv) (a) and (b). We recommend that paragraph 41(c)(iv) be revised to state “Other communication to external parties about the firm’s system of quality management, ~~in a transparency report or otherwise~~, when the firm determines it appropriate to do so” and moving what is in (a) and (b), and the reference to transparency reporting, to application material.

We are concerned that firms will believe that a communication “system” must be formal and very structured. Application material addressing what a communication system would look like, particularly for SMPs, would be very helpful.

**11. Do you agree with the proposals addressing the scope of engagements that should be subject to an engagement quality review? In your view, will the requirements result in the proper identification of engagements to be subject to an engagement quality review?**

We have concerns with the proposals addressing the scope of engagements subject to engagement quality review. We believe that firms will struggle with interpreting “of significant public interest”. We have noted several recommendations below with respect to (1) revising the presentation of paragraph 37; (2) clarifying that professional judgment is a factor in determining engagements subject to public interest; (3) revising application guidance to indicate the interaction of those determinations in a risk-based approach; and (4) certain drafting revisions to enhance the clarity of the guidance.

The order of the engagements for which an engagement quality review is required in paragraph 37e (that is, e (i), (ii) and (iii) (a) and (b)) could be clarified. We believe the four types of engagements encompassed in paragraph 37e fall into the following two categories:

- Engagements for which the criteria for determination of whether to perform an EQR is not established by the firm:
  - Audits of listed entities [par. 37e(i)]
  - Engagements for which law or regulation requires an EQR [par. 37e(iii)(a)]
- Engagements for which the firm has to exercise professional judgment to establish the criteria for determining whether to perform an EQR:
  - Audits of entities that the firm determines are of significant public interest [par. 37e(ii)]
  - Engagements for which the firm determines an EQR is an appropriate response to a quality risk [par. 37e(iii)(b)]

Accordingly, we recommend revising paragraphs A100-A107 to convey that determining whether an entity is of significant public interest is a matter of professional judgment, and that, given the risk-based approach, a firm’s determination of significant public interest would also be impacted by the considerations in 37(e)(iii) as noted in our discussion of employee benefit plans below. It would be helpful if the considerations provided in paragraph A102 included parameters against which to measure these factors.

In addition, paragraphs A100-A107 should be revised to convey that determining whether an entity is of significant public interest is a matter of professional judgment. It would be helpful if the considerations provided in paragraph A102 included parameters against which to measure these factors

Firms may do many audits of entities that could be considered of significant public interest regardless of size or risk. For example, employee benefit plans may be of significant public interest because they involve the management of participant money and safeguarding their future. A firm whose practice consists entirely of, for example, employee benefit plan audits may be able to identify characteristics of such audits for which an EQR is an appropriate response to the quality risk related to those characteristics. Such a firm also might determine that an effective response to the quality risk might be performing engagement quality reviews on a representative sample of such audits, given the firm's significant experience with those types of engagements. Application guidance may be helpful in this area to assist firms in making judgements that would be consistent with the requirement in paragraph 37e(ii).

The last sentence in paragraph A102 can be interpreted as "certain banks, [all] insurance companies, and [all] pension funds", and not "certain banks, *certain* insurance companies, and *certain* pension funds". We believe the intent to be that whether the firm determines an entity, such as financial institution like a bank, insurance company or pension fund, to be of significant public interest depends on the characteristics of the specific entity and not only on the type of entity such as, for example, a financial institution. Making this explicit would be helpful. Further, guidance about how to make the determination discussed in paragraph A107 would be helpful so that paragraph A107 is not interpreted as creating a de facto requirement to perform an engagement quality review on every engagement in the public sector for which law or regulation establishes additional reporting requirements. This would scope in almost every audit of a government or not-for-profit organization in the United States, regardless of whether quality risks exist that warrant an engagement quality review.

We are not clear on the point of paragraph A101; we believe it to be that the different triggers for EQR are not mutually exclusive. To clarify this and to be consistent with paragraph A27 of ISQM 2, which states that the procedures performed by the EQR may depend on the reasons for the assessments given to quality risks, we recommend the following revision to paragraph A101:

A101. The categories of engagements for which an engagement quality review is required are not mutually exclusive. ***The nature and extent of procedures performed by the engagement quality reviewer may be reflective of all the reasons for the assessments given to quality risks that resulted in the engagement being subject to an engagement quality review.***

12. In your view, will the proposals for monitoring and remediation improve the robustness of firms' monitoring and remediation?

In particular:

(a) Will the proposals improve firms' monitoring of the system of quality management as a whole and promote more proactive and effective monitoring activities, including encouraging the development of innovative monitoring techniques?

We support the proposals for monitoring the system as a whole. While it is unclear to us how the proposals will lead to the development of innovative monitoring techniques, we do not believe they will impede that development either.



We support the inclusion of the ability to inspect in-process engagements as monitoring procedures; this will be helpful primarily to larger firms. An explanation in paragraph A170 about how reviews of in-process engagements can meet the requirements of both ISA 220 and ISQM 1, by feeding the findings into the firm's monitoring system, would be helpful.

(b) Do you agree with the IAASB's conclusion to retain the requirement for the inspection of completed engagements for each engagement partner on a cyclical basis, with enhancements to improve the flexibility of the requirement and the focus on other types of reviews?

We believe that this requirement should include the flexibility to inspect completed portions of in-process engagements, not only completed engagements, because we believe this principles-based approach could provide for modernization and continuous improvement. We are aware of firms that are using cloud-based, data-visualization tools to provide real-time insights into their in-process engagements and inspection monitoring activities. These new tools provide avenues for continuous improvement and more timely and robust risk assessment. It also allows for faster root-cause assessment and remediation.

(c) Is the framework for evaluating findings and identifying deficiencies clear and do you support the definition of deficiencies?

We support the definition of deficiencies. However, the distinction between findings and deficiencies is not clear. We believe that *findings* and *deficiencies* as used in ED-ISQM 1 are equivalent to *deficiencies* and *significant deficiencies*, respectively, as those terms are used in ISA 265, *Communicating Deficiencies in Internal Control to Those Charged With Governance*. Using the same terms with different meanings is confusing. The chart at paragraph 68, page 23, of the Explanatory Memorandum is clearer than paragraphs 47-48 of ED-ISQM 1 at showing how findings become deficiencies. However, even within the chart, it is not clear how it is determined whether a negative finding is a deficiency. Paragraph A175 of ED-ISQM 1 indicates that the nature, severity and pervasiveness of the finding are considerations in determining whether the finding is a deficiency. The difference between the evaluation of findings to determine whether deficiencies exist required in paragraph 47 of ISQM 1, and the evaluation of the severity and persuasiveness of the identified deficiencies required in paragraph 48 is not clear. For example, are these two distinct steps or part of an iterative process?

We believe that paragraph 51 is an engagement-level requirement that belongs in engagement level standards, not in ED- ISQM 1. That notwithstanding, the use of "finding" and "deficiency" in paragraphs 51 and A185 is confusing. The last sentence in paragraph A185 implies that a finding that procedures were omitted or an inappropriate report was issued is considered to be a deficiency (whether in the engagement or the system of quality management, or both, is unclear). However, the use of the word "finding" in the headings and first sentence of paragraph 51 is confusing. Likewise, the use of findings in paragraph A185's heading but the reference to a deficiency in the last sentence of that paragraph is not clear.

We believe it would be helpful to indicate that deficiencies arise from negative findings. We also believe that references to negative findings will put more emphasis on positive findings, by contrast. We propose the following revisions to paragraphs 51, A173, A175, and A185:

**Negative Findings About a Particular Engagement**



51. In circumstances when a **negative** finding **that has been determined to be a deficiency** relates to an in-process or completed engagement and there is an indication that procedures required were omitted during the performance of the engagement or the report issued may be inappropriate, the firm shall: ...

A173. Positive findings, **while not required to be subject to additional actions**, may be useful to the firm as they indicate practices that the firm can support or apply more extensively, for example, across all engagements. They may also highlight opportunities for the firm to enhance the system of quality management.

A175. Factors that a firm may consider in determining whether a **negative** finding is a deficiency include:...

#### **Negative** Findings About a Particular Engagement (Ref: Para. 51)

A185. In circumstances when procedures were omitted or the report issued is inappropriate, the action taken by the firm may include:

- Consulting with appropriate individuals within the firm regarding the appropriate action.
- Discussing the matter with management of the entity or those charged with governance.
- Performing the omitted procedures.

The actions taken to correct the work performed for a specific engagement does not relieve the firm of the responsibility to investigate the root cause(s) of the identified deficiency related to the engagement.

(d) Do you agree with the new requirement for the firm to investigate the root cause of deficiencies?

We support the requirement for root cause analysis. Because not all firms are currently performing root cause analysis, implementation support materials for firms of various sizes and natures will be essential in order for a root cause analysis to be meaningful and not an empty exercise. For example, implementation support can cover items such as how root cause analysis performed for engagement level deficiencies can be evaluated in relation to the overall system of quality management. It could also cover items such as best practices to seek out the true root cause rather than settling on an early answer. We also recognize that the ability to perform root cause analysis improves with experience, and experience comes with time.

To avoid the impression that a root cause analysis is necessary for every deficiency regardless of its severity, we suggest changing the order of the words in paragraphs 12(b) and 48 of ED-ISQM 1, as follows:

12 (b) “**Evaluating the severity and pervasiveness of the identified deficiencies and investigating** ~~investigating the root cause(s) of the identified deficiencies and evaluating the severity and pervasiveness of the identified deficiencies~~”

48. The firm shall establish policies or procedures addressing:

~~(ba) **The evaluation of the severity and pervasiveness of the identified deficiencies, including the effect of the identified deficiencies, individually and in aggregate, on the system of quality management as a whole; and-**~~ (Ref: Para. A183)

~~(ab) The investigation of the root cause(s) of the identified deficiencies, including that the nature, timing and extent of the procedures to be performed to investigate the root cause(s) take into account the nature of the identified deficiencies and their possible severity.;~~ and (Ref: Para. A178–A182)

~~(b) The evaluation of the severity and pervasiveness of the identified deficiencies, including the effect of the identified deficiencies, individually and in aggregate, on the system of quality management as a whole. (Ref: Para. A183)~~

In particular:

i. Is the nature, timing and extent of the procedures to investigate the root cause sufficiently flexible?

The only specificity in the proposed standard about the nature, timing and extent of the procedures to investigate the root cause is that they take into account the nature of the identified deficiencies and their possible severity. This is sufficiently and appropriately flexible. While we do not believe that guidance on how to perform a root cause analysis is appropriate within the standard, many firms will need to undergo training and use support materials in order to be able to perform a meaningful root cause analysis.

ii. Is the manner in which ED-ISQM 1 addresses positive findings, including addressing the root cause of positive findings, appropriate?

Yes. We agree that firms may find it useful to address the root cause of positive findings to get reassurance that they are sustainable. The IAASB may wish, as part of post-implementation review, to see what further actions, if any, most firms do regarding positive findings.

(e) Are there any challenges that may arise in fulfilling the requirement for the individual assigned ultimate responsibility and accountability for the system of quality management to evaluate at least annually whether the system of quality management provides reasonable assurance that the objectives of the system have been achieved?

We support this requirement. Guidance addressing what would necessitate a “more frequent” evaluation would be helpful.

**13. Do you support the proposals addressing networks? Will the proposals appropriately address the issue of firms placing undue reliance on network requirements or network services?**

We support the proposals addressing networks. We suggest that paragraph A201 incorporate the idea that the information obtained from the network is at an appropriate level of aggregation. We would not expect, for example, that the network would provide detailed information on the specific engagements



selected and individuals reviewed to other firms in the network, but rather would provide aggregated information about the results to other member firms. We believe this aligns with the language in paragraph A201, but that paragraph A201 could more clearly state this. For example:

The information about the overall scope and results of the monitoring activities across the network firms' system of quality management may highlight trends and common areas of identified deficiencies across the network, or examples of quality that may be replicated across the network. Such information may be used by the firm to determine the nature, timing and extent of its monitoring activities. It may also indicate deficiencies in network requirements or network services used by the firm for its system of quality management. ***Any such deficiencies could be communicated at an aggregated or thematic level.***

**14. Do you support the proposals addressing service providers?**

We support the proposals; however, we believe that there will be divergence in practice as to how these will be applied. For example, firms will differ in how they assess the level of risk associated with using commercial IT applications and the corresponding response. Application material or other support material providing considerations for, and examples of, assessing risk and designing responses would be helpful.

**15. With respect to national standard setters and regulators, will the change in title to "ISQM" create significant difficulties in adopting the standard at a jurisdictional level?**

The change in title will not present significant difficulties for the ASB in converging with the standard. We have consulted with National Association of State Boards of Accountancy, and they have indicated that they do not foresee difficulties with respect to the change in title at the state level in the United States.

## **Editorial Comments on Proposed ISQM 1**

### *Paragraph 10*

The distinction between "will" and "may" is not always clear to users of the Proposed Standards. We suggest the following change to paragraph 10(a) to clarify that it is a fact that the nature, timing and extent of responses are based on the reasons underlying the risk assessed.

- (a) Designing and implementing responses to address the assessed quality risks. The nature, timing and extent of the firm's responses to address the assessed quality risks ~~will be~~ **are** based on, and responsive to, the reasons for the assessments given to the quality risks. ...

### *Paragraph 34*

The overarching quality objective with regard to client acceptance and continuance is that the firm only accept and continue client relationships and specific engagements that are appropriate in the circumstances. Judgments are made in order to determine the firm's conclusion that it will, or will not, accept or continue a client relationship or specific engagement, and it is that conclusion that must be appropriate. Accordingly, we suggest the following changes to paragraphs 34(a) and 34 (c):

- (a) The firm obtains sufficient appropriate information about the nature and circumstances of the engagement and the integrity and ethical values of the client (including management, and, when appropriate, those charged with governance) and based on such information makes appropriate ~~judgments~~ **conclusions** about whether to accept or continue a client relationship or specific engagement. (Ref: Para. A77–A82)
- (c) The firm's financial and operational priorities do not lead to inappropriate ~~judgments~~ **conclusions** about whether to accept or continue a client relationship or specific engagement. (Ref: Para. A85– A86)

#### *Paragraph A100*

We believe that paragraph A52 of ISQC 1 provides valuable guidance that is particularly helpful when differences of opinion arise between the engagement partner and the engagement quality reviewer. We suggest that it be incorporated into paragraph A100 of ED-ISQM 1 as follows:

A100. The policies or procedures addressing differences of opinion may be established in a manner that encourages identification of differences of opinion at an early stage, ***provides clear guidelines about the successive steps to be taken thereafter, and requires documentation regarding the resolution of the differences and the implementation of the conclusions reached.*** Procedures to resolve such differences may include consulting with another practitioner or firm, or a professional or regulatory body.

### **III. Comments on Proposed ISQM 2**

#### **Proposed ISQM 2 Questions**

- 1) Do you support a separate standard for engagement quality reviews? In particular, do you agree that ED-ISQM 1 should deal with the engagements for which an engagement quality review is to be performed, and ED-ISQM 2 should deal with the remaining aspects of engagement quality reviews?

We support a separate standard for engagement quality reviews and generally agree with how the related requirements are placed in ED-ISQM 1 and ED-ISQM 2. See specific comments below.

We agree, as stated in paragraph 11 of the explanatory memorandum, that a separate standard emphasizes the importance of an engagement quality review. When an engagement is identified as requiring an engagement quality review, a separate standard also facilitates having all requirements related to the firm's performance of that review in one location. Consequently, like the changes in ED- ISA 220, we propose that conforming amendments be considered to other assurance standards, such as ISAE 3000, to limit their focus to the engagement team's procedures and for ISQM 2 to exclusively address the engagement quality reviewer's procedures.

- 2) Are the linkages between the requirements for engagement quality reviews in ED-ISQM 1 and ED-ISQM 2 clear?



Overall, we believe the linkages are clear, but have a suggestion for improvement.

We are concerned that the phrase “all engagements for which an engagement quality review is required to be performed in accordance with proposed ISQM 1” may be subject to misinterpretation. Paragraph 37e(iii)(b) of ED-ISQM 1 requires that firms require an engagement quality review for certain engagements. Audits of financial statements of listed entities or audits or other engagements for which an engagement quality review is required by law or regulation, are clearly required by ED-ISQM 1. However, because an engagement for which the firm determines that an engagement quality review is an appropriate response to assessed quality risks is dependent on the nature and circumstances of that engagement, some practitioners may inappropriately fail to consider that engagements subject to engagement quality review based on the firm’s determination of the risks of those engagements are included in the concept of engagement quality reviews that are required by ED-ISQM 1. We believe that the guidance in paragraph A88 of ED-ISA 220 provides a helpful explanation of the interrelationship among the standards. We believe this guidance would also be applicable and helpful within this standard. We recommend adding the following language to paragraph 2 to clarify the scope of applicability of the standard:

2. This ISQM applies to all engagements for which an engagement quality review is required to be performed in accordance with proposed ISQM 1, **including when the firm has determined that an engagement quality review is an appropriate response to assessed quality risks**. This ISQM is premised on the basis that the firm is subject to proposed ISQM 1 or to national requirements that are at least as demanding.

- 3) Do you support the change from “engagement quality control review/reviewer” to “engagement quality review/reviewer?” Will there be any adverse consequences of changing the terminology in respondents’ jurisdictions?

We support this change. We believe it is consistent with the change from ISQC to ISQM. We are not aware of any adverse consequences of this change.

- 4) Do you support the requirements for eligibility to be appointed as an engagement quality reviewer or an assistant to the engagement quality reviewer as described in paragraphs 16 and 17, respectively, of ED-ISQM 2?

We do not support the requirement in paragraph 16 to include limitations on the eligibility of an individual to be appointed as engagement quality reviewer for an engagement on which the individual previously served as engagement partner. We believe that the requirement should address the objectivity of the engagement quality reviewer, which may be impacted by a previous role as engagement partner. This would make the requirement in paragraph 16 appropriately principles-based. We describe this more fully in our response to 4(a) below.

In addition to our responses to 4(a) and 4(b) below, we have the following recommendations regarding the appointment and eligibility of the engagement quality reviewer:

To retain valuable guidance regarding the objectivity of the engagement quality reviewer, we recommend the following revision to paragraph A3, consistent with paragraph A49 of ISQC 1:

A3. In certain circumstances, it may not be practicable for an individual other than a member of the engagement team to appoint the engagement quality reviewer, for

example, in the case of a smaller firm or a sole practitioner. ***The firm’s policies and procedures may include that the engagement quality reviewer, to the extent practicable, is not selected by the engagement partner.***

We believe it would be helpful to include application guidance for firms to consider the process related to the handover of responsibilities and transfer of information from the current engagement quality reviewer to the replacement reviewer when the need to transition the engagement quality reviewer on an in-process engagement is identified. We would recommend an additional paragraph, such as the following, be added to the application guidance related to paragraph 19 after paragraph A21:

***A21X. The firm’s policies and procedures may also include guidance related to engagement performance and documentation when the replacement of an engagement quality reviewer occurs during an in-process engagement. This may include:***

- ***Evaluation of whether any review work that has been performed by the engagement quality reviewer could be relied upon by the newly assigned engagement quality reviewer or whether all work would need to be reperformed***
- ***Consideration of the effect of an engagement quality review assistant on the transition, when such assistant has been involved in the engagement quality review prior to transition***
- ***Procedures undertaken by the engagement team to inform the newly assigned engagement quality reviewer about planning meeting discussions that have already occurred and other matters in which the previous engagement quality reviewer had been involved***
- ***Documentation of the circumstances necessitating the change***

- (a) What are your views on the need for the guidance in proposed ISQM 2 regarding a “cooling-off” period for that individual before being able to act as the engagement quality reviewer?

We believe that the requirement should address the objectivity of the engagement quality reviewer and guidance should address the need for safeguards such as cooling-off periods and assessing competency.

We are not convinced that the engagement quality review would be less effective because the reviewer previously served on the engagement. We do believe this is a scalability issue; however, not one that is necessarily limited to small firms. Requiring a cooling-off period could result in firms that rotate engagement partner and engagement quality reviewer roles within a group of partners needing to use an external provider. This might have the unintended consequence of such firms choosing not to rotate engagement leadership (if not otherwise required to do so), which would not be an improvement in quality. We are also concerned about the availability of qualified resources with specific and relevant skill sets, such as a particular industry or topic-specific expertise. Given limited resources, for an engagement risk in which an engagement quality review is the appropriate response, an experienced person who recently served as the engagement partner could be a more effective engagement quality reviewer than someone else with less experience or competency related to that engagement risk.

We are concerned that paragraph A5 will be interpreted as creating a de facto requirement to have a 2-year cooling-off period for all engagements, not just listed entities, and certainly for entities of “significant public interest. If the reason for selecting a two-year period is related to an entity presenting comparative

financial statements, that should be made clear, as many entities, such as local governments, often do not present comparative financial statements. Firms could then include whether the entity presents comparative financial statements as a consideration in determining the eligibility of an engagement quality reviewer.

We believe that the requirement for a cooling-off period is prescriptive and not principles-based. We note that such a requirement may result in a lessening in audit quality as some firms may follow the letter of the requirement but not the principle upon which the requirement is based. Accordingly, we urge the IAASB to revise this requirement to be more principles-based. Further, we would prefer that the example in paragraph A5 be revised to refer to a regulator who requires a 2-year cooling off period.

Accordingly, we recommend the following revisions to paragraphs 16 and A5:

16. The firm shall establish policies or procedures that set forth the criteria for eligibility to be appointed as an engagement quality reviewer and that include **policies and procedures designed to maintain the objectivity** ~~limitations on the eligibility~~ of an individual to be appointed as engagement quality reviewer for an engagement on which the individual previously served as engagement partner. Those policies or procedures shall require that the engagement quality reviewer not be a member of the engagement team, and: ...

A5. **Policies and procedures designed to maintain the objectivity of an engagement quality reviewer** ~~An individual who has served as the engagement partner on the previous year's engagement may address the following areas is not likely to be able to perform the role of the engagement quality reviewer immediately after ceasing to be the engagement partner because it is not likely that the threats to the individual's objectivity with regard to the engagement and the engagement team can be reduced to an acceptable level.:~~

- **The extent of changes in** ~~In recurring engagements,~~ the matters on which significant judgments are made and the facts and circumstances around those significant judgments **compared to the period(s) in which the individual was the engagement partner** ~~are not likely to vary to a degree such that an objective evaluation of those judgments can be made by the individual who served as the engagement partner in the immediate previous period.~~
- **The procedures and incentives placed by the firm's system of quality management on objective reviews (for example, the engagement quality reviewer would not be penalized for identifying a misstatement related to a year in which the reviewer was the engagement partner)**

Accordingly, this ISQM requires the **A** firm **may** to establish policies or procedures that limit the eligibility of individuals to be appointed as engagement quality reviewers who previously served as the engagement partner, for example, by establishing a specified cooling-off period during which the engagement partner is precluded from being appointed as the engagement quality reviewer. Determining a suitable cooling-off period depends upon the facts and circumstances of the engagement, and applicable provisions of law or regulation or relevant ethical requirements. ~~In the case of~~ **For example, the IESBA Code and certain regulators require that for** an audit of financial statements of a listed entity, ~~it is unlikely that~~ an engagement partner ~~would~~ **is not** be able to act as the engagement quality reviewer until two subsequent audits have been conducted.

- (b)  If you support such guidance, do you agree that it should be located in proposed ISQM 2 as opposed to the IESBA Code?

No, we believe both the guidance and any requirement for a cooling off period should be maintained within the IESBA Code. However, if guidance is retained within this standard, we believe it should be limited to illustrative examples as demonstrated in our response above.

- 5) Do you agree with the requirements relating to the nature, timing and extent of the engagement quality reviewer's procedures? Are the responsibilities of the engagement quality reviewer appropriate given the revised responsibilities of the engagement partner in proposed ISA 220 (Revised)?

In general, we believe that the responsibilities of the engagement quality reviewer are appropriate, with some specific comments.

We believe that an engagement quality review is an objective review of the engagement team's significant judgments, including the date selected by the engagement team to date the report. Accordingly, we suggest that the requirement that the engagement quality review be performed before the report is dated be changed to before the report is released, with the caveat that, when the engagement quality review results in additional procedures having to be performed, the date of the report would be changed. This change would more closely align the dating requirements with other standard setters to allow for more consistency in application.

We also believe that although the engagement quality reviewer is not a member of the engagement team, the engagement quality reviewer should satisfy the independence requirements relating to the engagements reviewed. We believe this is broadly addressed in the requirement in paragraph 16(b). However, we believe an explicit reference to independence in application material would be helpful in reminding practitioners of this important consideration. We suggest the following edits to paragraph A13 to incorporate the concept of independence:

A13. The relevant ethical requirements that are applicable when undertaking an engagement quality review may vary, depending on the nature and circumstances of the engagements subject to an engagement quality review. **For example, requirements for the engagement quality reviewer to be independent of the entity for whom the engagement is being performed would be relevant for audit engagements but may not be relevant for related services engagements.** Various provisions of relevant ethical requirements may apply only to individual professional accountants, such as an engagement quality reviewer, and not the firm. **For example, if a firm uses an external provider to perform an engagement quality review, that individual may be subject to independence requirements, but the entire firm for whom the individual works may not need to comply with independence requirements related to the entity.**

We note that paragraph 22a(ii) refers to results of monitoring "provided" by the firm, whereas ED-ISQM 1 discusses "communication" related to monitoring (paragraphs 52-54 of ED-ISQM 1), ED-ISA 220 paragraph 36a refers to results "as communicated" by the firm. We suggest that, to be consistent, paragraph 22a(ii) refer to results of monitoring "communicated" by the firm. We believe that using the term "communicated" is preferable to "provided" because of the linkage to the terminology in the ED-ISQM 1 of the information and communication component of the firm's system of quality management.

In paragraph 22(g), the engagement quality reviewer is instructed only to "review" the financial statements and auditor's report thereon. In the other subpoints to paragraph 22, the action of the engagement quality reviewer is more clearly defined (i.e., read and understand, review and evaluate). We believe it is not clear what the objective of the engagement quality reviewer's "review" is intended to be. We believe that



the clarity of ED-ISQM 2 could be improved by adding a new application paragraph related to 22(g), such as the following:

**AX. *The review of the financial statements and the auditor's report thereon is performed to evaluate items such as:***

- ***The compliance of the auditor's report with appropriate professional standards, including the appropriateness of the report in relation to the conclusions reached in the audit of the financial statements***
- ***The compliance of the financial statements with the applicable financial accounting framework***
- ***When applicable, the faithful representation of key audit matters to documentation of such items within the engagement working papers.***

Paragraphs 34–36 of the explanatory memorandum are helpful in clarifying confusion between significant judgments and significant matters. Paragraph 35 of the explanatory memorandum states that “[t]he IAASB concluded that the engagement quality reviewer’s review of the engagement team’s significant judgments in ED-ISQM 2 needed to be consistent with the approach taken in relation to the engagement partner’s review of audit documentation in ED-220.” Because these concepts are fundamental to an engagement quality review and its consistent application, we believe that this concept should be included in application material in ED-ISQM 2 as follows:

A30. For audits of financial statements, ***the engagement quality reviewer’s review of the engagement team’s significant judgments is consistent with the approach taken in relation to the engagement partner’s review of audit documentation in proposed ISA 220 (Revised).*** ***Proposed ISA 220 (Revised)*** provides examples of significant judgments that may be identified by the engagement partner related to the overall audit strategy and audit plan for undertaking the engagement, the execution of the engagement and the overall conclusions reached by the engagement team.

For engagements other than audits, specific guidance about significant judgments and significant matters in the context of other assurance engagements is needed to aid consistent application (i.e., the suggestion in paragraph A31 of ED-ISQM 2 that the ISA 220 guidance may be helpful in this regard is not sufficient on its own). We recommend that guidance related to these concepts either be included directly in ED-ISQM 2 or consideration be given to consequential amendments to the IAASB standards that address assurance engagements.

We also suggest making it explicit in paragraph 23 of ED-ISQM 2 that the firm’s policies or procedures to address differences of opinion, required to be established by paragraph 37(d) of ED-ISQM 1, would apply in instances when the engagement quality reviewer’s concerns are not satisfactorily resolved by the engagement partner. The guidance in paragraph A100 of ED-ISQM 2 that “[p]rocedures to resolve such differences may include consulting with another practitioner or firm, or a professional or regulatory body” would be helpful here as well. Further, it would aid scalability for SMPs to note in paragraph A35 that there may not be an appropriate individual within the firm, other than the engagement partner, to notify pursuant to the requirement in paragraph 23.

To avoid an interpretation that the firm could issue a report for an engagement with an incomplete engagement quality review, we recommend that application material be added that effective policies and procedures addressing differences of opinion require that conclusions reached be documented and



implemented and the report not be released until the matter is resolved. The last sentence of paragraph A100 of ED-ISQM 1 could be included as paragraph A35X.

- 6) Do you agree that the engagement quality reviewer's evaluation of the engagement team's significant judgments includes evaluating the engagement team's exercise of professional skepticism? Do you believe that ED-ISQM 2 should further address the exercise of professional skepticism by the engagement quality reviewer? If so, what suggestions do you have in that regard?

We agree that the engagement quality reviewer's evaluation of the engagement team's significant judgments includes evaluating the engagement team's exercise of professional skepticism. We think that could be made more explicit with the following revision to paragraph 23:

23. If the engagement quality reviewer has concerns that the significant judgments made by the engagement team, ***including when applicable, the appropriate exercise of professional skepticism by the engagement team***, or the conclusions reached thereon, are not appropriate...

We do not believe that ED-ISQM 2 should further address the exercise of professional skepticism by the engagement quality reviewer. Doing so would necessitate defining what "being alert to conditions which may indicate possible misstatement, and a critical assessment of evidence" means in the context of an engagement quality review.

- 7) Do you agree with the enhanced documentation requirements?

Yes.

- 8) Are the requirements for engagement quality reviews in ED-ISQM 2 scalable for firms of varying size and complexity? If not, what else can be done to improve scalability?

We believe that, generally, the requirements are scalable. We believe, as expressed in our response to question #4 above, that the limitations on the eligibility of an individual to be appointed as an engagement quality reviewer for an engagement on which the individual previously served as engagement partner, as required by paragraph 16 of ED-ISQM 2, are not scalable to SMPs. As noted above, we believe that focusing the requirement on the objectivity of the engagement quality reviewer and not requiring a "cooling-off" period would be both principles-based and scalable.

## Editorial Comments on Proposed ISQM 2

### Paragraph 3

Consider moving paragraph 3 to after paragraph 5 to align with the title of this section (i.e., first discuss ISQM 1, then introduce engagement quality reviews).

### Paragraph 7



We agree that “the engagement team may obtain further evidence through its responses to matters raised in the engagement quality review”. However, the wording earlier in this paragraph “nor does it change the nature, timing and extent of procedures that need to be performed by the engagement team” seems to be contradictory and we suggest it be modified because responding to matters raised in the engagement quality review would likely result in obtaining further evidence.

*Paragraph 9(b)*

We recommend revising references to other assurance engagements so that they are consistent throughout the standard. For example, this paragraph refers to “Other engagements” while paragraph 4 refers to “or other assurance or related services engagements performed by the firm, ...”. Further, ISQM 1 paragraph 37(e)(iii) refers to “Audits or other engagements for which:”.

*Paragraph 10*

Because an engagement quality review is defined as “an objective evaluation ... performed by the engagement quality reviewer”, the objective of the firm is to perform a review performed by the reviewer. We suggest that the objective be revised to state that the objective of the firm is to determine that an engagement quality review is performed by the engagement quality reviewer. This has the advantage of bringing the reviewer into the objective. In addition, we suggest that the words “performed by the engagement quality reviewer and” be deleted from the definition of an engagement quality review, as they are redundant with the definition of an engagement quality reviewer.

*Paragraph 24*

The first sentence of paragraph 24 can be more concisely phrased as “The engagement quality reviewer shall determine whether the engagement quality review has been performed and completed in accordance with the requirements in this ISQM.”

*Paragraph 27*

Consider explicitly including documentation of the engagement quality reviewer’s evaluation of the conclusion in the auditor’s or engagement report in accordance with paragraph 22(g).

Paragraph 27c and d seem repetitive. Paragraph 23 only requires communication if concerns are identified, whereas the notification requirement in paragraph 24 is always applicable. We recommend the following edit to paragraph 27:

- c) The engagement quality reviewer’s determination in accordance with, **and any notifications required by**, paragraph 24 ~~23~~;
- d) The notifications required in accordance with paragraphs ~~23 and~~ 24; and

*Paragraph A4*

Consider moving this paragraph to later in the application and other explanatory material, for example, after paragraph A16. This might improve the flow of the guidance by discussing what the eligibility characteristics are in advance of indicating that those characteristics may not exist within the firm.

*Paragraph A6*

The wording of the last bullet raises the question of why relevant training is mentioned with respect to the responsibilities of the engagement quality reviewer, when relevant training may provide or enhance every



other bullet in this list. If the intent is that specific training on these responsibilities may be needed, please state that more clearly.

The inclusion of the term “values and attitudes” raises concern about how these would be defined and measured.

*Paragraph A7*

The second sentence of this paragraph makes a leap from the firm’s quality risks to a specific engagement. We suggest this paragraph be clarified to avoid misinterpretation that quality risks are assessed for an individual engagement. We believe the understanding should be of the reasons that an engagement quality review was determined to be an appropriate response to the quality risks related to performing that engagement.

*Paragraph A20*

Revise as follows: “Factors that may be relevant to the firm in considering whether the eligibility of the engagement quality reviewer to perform the engagement quality review ~~is~~ **becomes** impaired include:”

*Paragraph A21*

Revise as follows:

A21. In circumstances in which the engagement quality reviewer’s eligibility to perform the engagement quality review becomes impaired, the firm’s policies or procedures may

- set out a process by which alternative eligible individuals are identified
- ~~or may~~ specify the period of time after notification within which the firm is required to appoint a replacement
- **set out considerations for re-performance of portions of the review if the engagement quality review had commenced.**

*Paragraph A32*

We recommend deleting the second sentence of this paragraph as paragraph 22(e) relates to the engagement quality reviewer’s evaluation of the team’s requirements to consult in accordance with the firm’s policies or procedures.

*Paragraph A34*

Because paragraph 22(f) relates to the audit of financial statements, we recommend deleting paragraph A34, which refers to other assurance engagements, to avoid confusion.

**IV. Comments on Proposed ISA 220 (Revised)**



## General Comments on Proposed ISA 220 (Revised)

### Objective

In reviewing the updated objective in ED-ISA 220, it is unclear how we would determine that an auditor has “managed quality at the engagement level to obtain reasonable assurance that quality has been achieved.” It is our recommendation that the objective of the extant standard be retained as it is more concise and measurable, with the minor change of updating “control” to “management.” Specifically, we propose the following wording for the objective of the standard:

9. The objective of the auditor is to ~~manage~~ **implement** quality **management procedures** at the engagement level to obtain reasonable assurance that ~~quality has been achieved such that~~:

(a) The auditor has fulfilled the auditor’s responsibilities, and has conducted the audit, in accordance with professional standards and applicable legal and regulatory requirements; and

(b) The auditor’s report issued is appropriate in the circumstances.

We believe retaining the extant objective with the minor wording change is clearer and will be better understood by auditors, while still being consistent with the enhancements to ISA 220 to address the engagement partner’s responsibility for managing quality on the engagement.

### Satisfied vs. determined

The explanatory memorandum for ED-ISA 220 clarifies the meaning of the phrases “shall be satisfied” and “shall determine;” however, this clarification is not included within the standard. We recommend that this be clarified within the standard as the phrase “shall be satisfied” is used in several requirements, and without a clear description, can be open to interpretation and may result in inconsistent application.

We recommend that the following paragraph be added after paragraph 10 within the Definitions section of ED-ISA 220 to clarify this:

10A. ***For purposes of this ISA, the following phrases used in the requirements have the meanings attributed below:***

(a) ***“shall be satisfied”- the engagement partner’s responsibility in relation to actions that occur (or should have occurred) at the firm level, but which are relevant to managing and achieving quality at the engagement level***

(b) ***“shall determine” – actions that the engagement partner is required to take or delegate with appropriate oversight***

## Proposed ISA 220 (Revised) Questions

- 1) Do you support the focus on the sufficient and appropriate involvement of the engagement partner (see particularly paragraphs 11–13 and 37 of ED-220), as part of taking overall responsibility for managing quality on the engagement? Does the proposed ISA appropriately reflect the role of other senior members of the engagement team, including other partners?

We support the focus on the sufficient and appropriate involvement of the engagement partner. We regret that we have no suggestions to improve the wording of the first sentence of paragraph 37 other than using “their” as singular.

- 2) Does ED-220 have appropriate linkages with the ISQMs? Do you support the requirements to follow the firm’s policies and procedures and the material referring to when the engagement partner may depend on the firm’s policies or procedures?

Yes, however we believe there could be improved clarification regarding the linkage to the requirements in ED-ISQM 1 related to the scope of ISA 220.

We are concerned that the phrase in paragraph 33 of ED-ISA 220 “all engagements for which an engagement quality review is required to be performed in accordance with proposed ISQM 1” may be subject to misinterpretation.

Paragraph 37e(iii)(b) of ED-ISQM 1 requires that firms require an engagement quality review for certain engagements. Audits of financial statements of listed entities or audits or other engagements for which an engagement quality review is required by law or regulation, are clearly required by proposed ISQM 1. However, because an engagement for which the firm determines that an engagement quality review is an appropriate response to assessed quality risks is dependent on the nature and circumstances of that engagement, some practitioners may inappropriately fail to consider that engagements subject to engagement quality review based on the firm’s determination of the risks of those engagements are included in the concept of engagement quality reviews that are required by ED-ISQM 1. We recommend adding the following language to paragraph A88 to clarify the scope of applicability of the procedures in paragraph 33:

A88. Proposed ISQM 1 requires that the firm establish policies or procedures that require an engagement quality review for certain types of engagements, ***including when the firm has determined that an engagement quality review is an appropriate response to assessed quality risks.***

- 3) Do you support the material on the appropriate exercise of professional skepticism in managing quality at the engagement level? (See paragraph 7 and A27–A29 of ED-220)

We suggest revisions to paragraph A27 and A29 to alleviate indications that these paragraphs are not being read as the IAASB intends. We have concerns that the list of impediments to the exercise of professional skepticism in paragraph A27 and possible actions that engagement partners may take to deal with such impediments in paragraph A29 could be interpreted as a list of instances that always give rise to an impediment of professional skepticism and a checklist of required actions when such instances are encountered, respectively. Further, paragraph A27 is being interpreted as indicating that professional skepticism cannot be exercised when such impediments exists. To address these misinterpretations, we suggest changing “impediments” to “obstacles” in paragraph A27 and revising the first sentence in paragraph A29 as follows: “Possible actions that the engagement partner may take to deal with

impediments **overcome obstacles** to the exercise of professional skepticism at the engagement level include.” We further suggest that application guidance be added to paragraph A29 that identifies factors for the engagement partner to consider when evaluating the extent of procedures performed when impediments to professional skepticism are identified. We believe this would increase scalability and reduce the risk of a one-size-fits-all approach.

- 4) Does ED-220 deal adequately with the modern auditing environment, including the use of different audit delivery models and technology?

Yes.

We believe that paragraph 26 could be further enhanced to more clearly state that technological resources that are not in the scope of the firm’s system of quality management are the responsibility of the engagement partner. For such technological resources, the engagement partner should have a responsibility to determine that such technological resources have been designed, implemented, and maintained properly, taking into account how the resources are intended to be used on the engagement.

- 5) Do you support the revised requirements and guidance on direction, supervision and review? (See paragraphs 27–31 and A68–A80 of ED-220)

Yes, particularly the reference in paragraph 29 to “appropriate points in time”.

- 6) Does ED-220, together with the overarching documentation requirements in ISA 230, include sufficient requirements and guidance on documentation?

Yes.

- 7) Is ED-220 appropriately scalable to engagements of different sizes and complexity, including through the focus on the nature and circumstances of the engagement in the requirements?

Yes.

### Editorial Comments on Proposed ISA 220 (Revised)

#### *Paragraph 13*

Consider revising paragraph 13a to incorporate the term “direct” and paragraph 13b to incorporate the terms “supervise” and “review”. Using these phrases would parallel the wording in paragraphs 27-31.

#### *Paragraph 22*

Revise as follows: If the engagement partner obtains information that may... so that the firm and the engagement partner can take the ~~necessary~~ **appropriate** action...

#### *Paragraph 36*

The application material reference should be A95 – A98.

#### *Paragraph 38(a)*



We recommend adding the word “Significant” to begin the sentence “Significant matters identified...” to avoid the impression that all “matters” identified regardless of significance be included in the documentation.

*Paragraph A8*

It is not clear who “other parties” might be.

*Paragraph A16*

Delete the last two sentences for reasons of clarity and brevity. The description of how the work of those who are not members of the engagement team becomes audit evidence through procedures performed by the auditor is tangential to the explanation of who is, and is not, a member of the engagement team. In a standard about quality management at the engagement level, in which only one requirement (in paragraph 38) is the responsibility of the “auditor” and all other requirements are addressed to either the engagement partner or the engagement team, it is confusing to have these sentences about the procedures the auditor performs.

*Paragraphs A22, A33, A34, A50, A53, A100 and A101*

We think that the readability of the application material would be improved if the references to the requirement paragraphs such as ‘in accordance with paragraphs 14 – 19’ or ‘in addressing the requirements in paragraphs 11 and 12’ were removed. It is redundant to refer to the requirement paragraphs when the sub-headings in the application and explanatory materials sections include the cross reference to the requirement paragraphs.

*Paragraph A30*

A30 is very helpful and the concepts therein should be included in the introductory section. We have a concern that the use of the word “determine” within ED-ISA 220 may be interpreted as a requirement that the engagement partner cannot delegate and has to personally carry out all related activities. The edits we provided above to add a new paragraph explaining the phrase “shall determine” would serve to address this concern. If those edits are not accepted, we believe A30 should be modified to be explicit that the word “determine” allows for delegation.

Thank you for the opportunity to comment on this exposure draft. If you have any questions regarding the comments in this comment letter, please contact me at [Mike.Santay@us.gt.com](mailto:Mike.Santay@us.gt.com) or Ahava Goldman at [ahava.goldman@aicpa-cima.com](mailto:ahava.goldman@aicpa-cima.com).

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Mike J. Santay". The signature is written in a cursive, flowing style.





/s/ Michael J. Santay

Chair, Auditing Standards Board