27 June 2019

International Auditing and Assurance Standards Board
529 Fifth Avenue
New York
10017

Dear Sirs,

Proposed International Standard on Quality Management 1 (ED-ISQM1)

We are pleased to have the opportunity to respond to the proposals laid out in the IAASB Group Consultation on ED-ISQM1. We set out below our overall comments on the consultation, followed by detailed responses to each question raised. In so doing, we are keen to distinguish between where we have comments or concerns in relation to the proposals and our suggestions that you may wish to consider.

Overall comments

Our overall comments on ED-ISQM1 are that:

- We fully support the move from a reactive standard on quality control to the more proactive approach to quality management, and overall the standard is moving in the right direction in that regard.

- The standard introduces enhanced requirements, greater complexity and further requirements around documentation and evaluation of the system of quality management. We are concerned that these enhanced requirements may not achieve the required outcomes of improvement in engagement quality, as measured by inspections of completed engagements, as many of the issues identified in individual engagements may not necessarily be addressed by changes to the system of quality management, e.g. “human error”, failure to sufficiently apply professional scepticism etc.

- We are particularly concerned that small and medium practices (SMPs) may find it difficult to implement the new standards due to a lack of resources and the need to focus on providing high quality engagements. Indeed, it has been argued at the recent “Less Complex Entities” working conference in Paris, that a small firm providing only a handful of relevant engagements may be better placed focussing its resources on delivering high quality engagements than taking up resources implementing a complex system of quality management which may or may not directly impact quality at the engagement level.

- Whilst introducing a risk assessment process is reasonable, we are concerned that defining “reasonable possibility” as “anything more than remote” will mean that there a very low bar for the identification of risks for which responses are required. This is likely to lead to an excessively large number of risks and associated responses, and by extensions resources, required to address the identified risks.

- We are disappointed that the IAASB has moved away from its original intention to include required risks in the standard in addition to required objectives and required responses. Indeed, we find it very difficult to understand how a risk assessment process can be incorporated into a standard which identifies responses which a firm is required to implement but to which there is no risk attached. It appears that the IAASB has taken the view that identifying risks is too difficult and has therefore delegated this to individual firms to resolve. Further support for firms in identifying quality risks is important.

- We are pleased to note that the IAASB has started to develop illustrative examples to support application of the requirements in the standard. However, the fact that these are needed, and the number of areas in...
which we and others have identified that further guidance/examples are needed, would indicate that there is overall a lack of clarity and true scalability in the standard.

- We are disappointed that the IAASB has not taken a “bottom-up” approach to enabling scalability in the new standard. We believe it would be more appropriate to develop baseline requirements for all firms, including sole practitioners and SMPs, and build additional requirements for larger, more complex firms. Instead the approach is to have complex requirements applicable to all firms, regardless of their size and nature, and to enable scalability through application material and additional guidance/examples, which will make consistent application of the standard more difficult. In saying this, however, we note that it is difficult to define what is a “smaller firm”. A definition of smaller firms could be based, for example, on the number of engagement partners (e.g. less than 3) or the number of relevant engagements which may be more easily applied consistently than a definition based on any financial measures.

- The implication throughout the standard that there is more to the system of quality management than the standard describes (i.e. firms are required to identify additional quality objectives, all quality risks and additional responses) means that by definition ED-ISQM 1 cannot be consistently understood or interpreted. As a result, there will be considerable grounds for disagreement where a quality management system is assessed or reviewed by a third party, such as an audit regulator. Furthermore, it will be difficult in many cases to effectively demonstrate compliance with the requirements of the standard to the satisfaction of a regulator.

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?**

**Response:** The greatest concern we have with the new standard overall is that there will be greater complexity, more requirements and enhanced documentation requirements to demonstrate compliance with the revised standard. However, despite this, it is not clear how implementing the requirements of the new standard, even with the further enhancements we have identified herein, will necessarily lead to improvements in audit quality at the engagement level. Further detail is provided in the comments which follow (see in particular 1(b) below).

In particular:

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

**Response:** We support the move to a more proactive quality management approach in replacing the existing emphasis on quality control. Whilst supportive of the general direction, and the importance of the risk assessment process in driving the quality management approach, we identify below our concerns regarding the ability of many firms to effectively implement the risk assessment requirements.

(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?**

**Response:** It is difficult to conclude on whether the proposals will directly benefit individual engagement quality. There are many instances under the current standard where a firm has appropriate arrangements in place to comply with ISQC1 but where individual engagements are subject to quality failings. As the objective of ISQC1 is not significantly different to the proposed...
objective of ED-ISQM1, it is difficult to conclude that establishing arrangements in accordance with the revised standard will necessarily lead to improved quality at the engagement level.

It is difficult to see how the implementation of ED-ISQM1 will directly lead to enhanced application of Professional Skepticism. This is a specific area on which the profession is, and should be, focused on making improvements but we do not believe ED-ISQM1 is the most appropriate means of doing so. Enhancements to ISAs would be a more appropriate vehicle if changes to the standards are the solution, although we believe that the solution may lie more in guidance and support for auditors rather than ever increasing standards.

(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?

Response: There are a number of approaches which can be taken to effect scalability. The most appropriate would be to build a bottom-up standard, with the basic requirements for all firms as a base with building blocks of more complex requirements for the larger, more complex firms providing a wider range of services etc. We believe that such a bottom-up approach is the most appropriate means of achieving scalability. We further understand that this approach was discussed as an option during the development of the standard and we regret that the IAASB did not follow this route.

Alternatives include a “top down” approach, whereby the more complex requirements which are not necessarily appropriate for smaller, less complex firms, may be determined as being not applicable. We understand that this approach is taken in some jurisdictions already (e.g. Netherlands).

Unfortunately, we do not believe that the approach adopted by the IAASB in developing the standard effectively takes either of these approaches and the successful scalability of the standard will be reliant on extensive guidance and the illustrative examples which the IAASB has begun to develop.

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?

Response: In general, a change on this scale will be difficult to implement for firms of all sizes, as acknowledge by the IAASB itself. It is imperative that sufficient time is allowed before the effective date of the standard and that the IAASB continues, and enhances, its helpful initiative of producing illustrative examples. See responses to individual questions where such challenges are addressed in more detail.

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?

Response: Whilst the application material is generally reasonable, we believe that greater value can be provided by the “Practical Examples” documents which the IAASB has proposed to introduce. We believe that these examples, subject to comments elsewhere in our response, will prove invaluable in providing practical assistance to firms implementing the new standards. It is particularly important that the “Practical Examples” address the needs of all types of firms; the current drafts address firms at the ends of the spectrum. We believe that examples of more “typical” firms, such as those smaller firms with one or a few partners but which provide a mix of audit and other assurance services to a range of sectors which are typical of many mid-tier networks, would be particularly helpful.
Specific Questions

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

Response: Yes. The eight components of ED-ISQM1 are appropriate and we also support the flexibility which the standard provides in enabling firms to adapt the components to their arrangements, and vice versa.

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?

Response: We support the shift in emphasis from more reactive Quality Control to a more proactive objective of Quality Management. However, ED-ISQM 1 has a strong focus on the creation of an administrative process but little on the relationship between this administration and execution at the engagement level, i.e. the actual achievement of quality in engagements. As a result, there remains the challenge that a firm may implement an appropriate system of quality management in accordance with the revised system but may still find that individual audits have significant quality findings or indeed, in extreme cases, an audit failure. With regards to the public interest, and public perception, it may be difficult for the firm, the IAASB, regulators and others to justify how a firm can have an appropriate system of quality management, giving them “reasonable assurance” around the quality of audit work, yet still issues may arise on individual engagements.

With regards to the Public Interest, there is little in the revised standard which explicitly requires the firm to act specifically in the public interest, other than the statement in ED-ISQM1.7 that “The Public Interest is served by the consistent performance of quality engagements”. There may remain a perception/expectation gap between reasonable assurance, as outlined in the paragraph above, and absolute assurance in this context. Other than that reference, the focus on public interest throughout the standard relates to “public interest entities”. Given the importance of SMEs to national and global economies, further emphasis of the wider “public interest” in the quality of engagements may be warranted.

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?

Response: Given that the standard requires the firm to identify quality objectives, risks and responses, we do believe that this will drive firms to identify these three factors. However, whether these objectives, risks and responses will be sufficient to prevent adverse audit findings and audit failures in and of themselves is doubtful. The vast majority of such findings relate to issues on specific audits, often arising due to “human” failings rather than systematic failings of the firm’s quality systems.

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?

Response: The proposed scope of the risk assessment process is reasonable.

However, it would be beneficial to bring the Risk Assessment Process to the forefront of the standard, ahead of the Governance and Leadership section and to clarify that the Risk Assessment Process applies to everything which follows in the standard. This would also assist in putting the required objectives and responses in the following sections into better context.
(b) Do you support the approach for establishing quality objectives?

Response: We support the approach of including required quality objectives in the standard. However, it is not clear how a firm might go about establishing any additional quality objectives over and above those required by the standard. (See comments below).

In particular:

i. Are the required quality objectives appropriate?

Response: Our thoughts on the quality objectives of each component are set out below:

Governance and Leadership
ED-ISQM1.23(a) – using the firm’s “Culture” makes this objective difficult to define and demonstrate. It may be more appropriate to say that “the firm’s leadership promotes a commitment…”. The leadership of the firm will directly impact its culture but is more easily identifiable.

ED-ISQM1.23(c) – the last sentence “by consistently performing quality engagements” seems superfluous. The objective that strategic decisions and actions demonstrate commitment to quality and the firm’s role in the public interest is sufficient without this additional dimension.

ED-ISQM1.23(e) – it seems incongruous to have a “required objective” which is only applicable when there are jurisdictional requirements. This objective should be removed and the firm’s commitment to complying with laws and regulations dealt with elsewhere, for example in the section “Applying and complying with relevant requirements”.

Relevant Ethical Requirements – No comments

Acceptance and Continuance of client relationships and specific engagements
ED-ISQM1.34(c) – the wording of this objective is overly complex with “do lead to inappropriate judgments” and may be difficult, for example, to translate and explain. We would recommend simplifying this objective to something like “The firm’s financial and operational priorities do not override appropriate decisions about whether to accept….”.

ED-ISQM1.34(d) – is this objective necessary given that there are already requirements in relation to this objective in the ISA 220?

Engagement Performance
ED-ISQM1.36(b) – although we acknowledge the fundamental importance of auditor judgment and the application of professional skepticism, it may be more appropriate requirements in this regard are established in the ISAs rather than in ED-ISQM1.

Resources
ED-ISQM1.38(d) – The first sentence of the requirement that “Personnel demonstrate a commitment to quality through their actions and behaviors” will be very difficult to demonstrate
in practice. The remainder of that objective is reasonable and more clearly demonstrable. We would suggest removing the first sentence of this objective.

*Information and Communication:*

ED-ISQM1.40(a) – The term “information system” will be very difficult to define in practice and also presents a significant challenge to scalability. Whilst it is relatively easy to envisage an information system for a large firm, what would this look like in a small single partner firm, or even more so in a sole practitioner? This is an area which, if it remains a requirement, will need to have some well-developed illustrative, practical examples to assist with implementation.

ED-ISQM1.40(c) – see earlier comments relating to “firm’s culture” promoting responsibility. We would suggest using “firm’s leadership” within the objectives.

*Monitoring and Remediation process*

ED-ISQM1.42(a) - refers to the components of the system of quality management which, by extension includes individual engagements. However, we believe that it would be appropriate to have a specific objective that “The monitoring and remediation process provides relevant, reliable and timely information about the quality of completed audit and assurance engagements”.

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

**Response:** Although this requirement is clear from ED-ISQM1.26, the standard would be clearer if this requirement was up front, before consideration of Governance and Leadership (see comments elsewhere) to set the context for required objectives.

It is not clear how a firm is likely to identify objectives over and above those required by the standard and we believe that many firms are likely to identify additional objectives only in limited circumstances. It would be helpful for the IAASB to provide examples of where they consider firms might identify additional objectives.

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

**Response:** No, we do not support the proposals for the identification and assessment of quality risks.

We are concerned that the IAASB has identified “required objectives” and “required responses” but has not identified the “required risks” to which the responses will apply. In earlier discussions with the IAASB, we understood that the Board also proposed to develop required risks. We are concerned that this is no longer the case. We believe that, for there to be an appropriate “required response”, then should be a corresponding “required risk”, otherwise it is not clear that the response will address the risk nor is it clear why the firm should implement the response.

We are concerned that the IAASB appears to have concluded that identification of risks in this context is difficult and that this should be left to firms to identify within the context of required objectives and responses. If the IAASB is unable to identify appropriate quality risks, we question how the Board expects audit firms, particularly those smaller, less sophisticated firms in jurisdictions where such approaches are less well developed, to identify the risks themselves. This is an example of where the IAASB has developed a complex, difficult standard where scalability is difficult to achieve.
Furthermore, we are concerned that there is a very “low bar” for the identification of quality risks with the standard stating that the firm is required to identify those risks which have a reasonable possibility of occurring; reasonable possibility is defined as “…the likelihood of its occurrence is more than remote” (ED-ISQM1.A55). We believe that this definition will lead to the identification of an excessively large number of quality risks which require responses. In conjunction with the lack of clarity provided by the IAASB not identifying required risks, this makes it difficult for firms to assess what is a “reasonable possibility”. However, we would not support the identification of a large number of risks which may be largely irrelevant to small and medium sized practices; as noted elsewhere we would support a more “bottom-up” or “building blocks” approach to the standard, including the identification of quality risks.

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

Response: In any risk assessment process it is important to identify appropriate responses to any assessed risks. However, we refer you to our earlier comments about the challenges in identifying risks and our concerns that the IAASB has proposed “required responses” but has not identified the risks that those responses are intended to address. It is therefore difficult for firms to understand the full context of the required responses.

Furthermore, we are concerned that there is a lack of consistency in the standard between the “required objectives” and the “required responses”. For each component there is a list of objectives followed by a list of responses. However, it is not clear how the responses map to the objective, let alone how these would link to the risks that the firm is required to identify. For example, the numbers of required objectives and required responses in certain components is as follows:

- Governance and leadership – six objectives but only three responses
- Ethical requirements – three objectives but four responses
- Acceptance and continuance – four objectives but only a single response
- Engagement performance – three objectives but six responses
- Resources – eight objectives but only a single response
- Monitoring & Remediation – only three objectives but then 13 paragraphs setting out responses.

In particular:

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?

Response: Subject to our comments above relating to the identification of risks, firms will be encouraged to develop a response to address identified risks. However, the success of firms in doing so will depend on the level of sophistication of the firm and the extent of awareness of such risk assessment techniques in jurisdictions around the world. This is likely to be a challenge for smaller, less sophisticated firms in jurisdictions where risk assessment is not embedded in the culture in the same way as it is in the majority of the larger, more advanced economies of the world.
We also draw your attention to our comments about the lack of "required risks" and the consequent inability to link the "required responses" to those risks.

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?

Response: No, we do not believe this is clear. Nor do we support that the firm should necessarily be expected to design responses in addition to those required by the standard. In our view it would be more appropriate to require additional responses only in those circumstances where they are required rather than in all circumstances. It may be that, for small and medium practices in particular, additional responses are only required in limited circumstances.

The reference to this requirement in ED-ISQM1.30 states that firms are required to implement responses “including the required responses in this ED-ISQM”. Whilst this statement may appear clear enough on the face of it, it may be lost in the wider context of a large, complex standard.

Furthermore, in the individual components of the standard, the requirements state “in designing and implementing responses…the firm shall include the following responses” (e.g. ED-ISQM1.24 relating to Governance and Leadership). Firms may not recognize the importance of the word “include” in this context and some smaller, less sophisticated firms are likely to take this as a definitive list of responses.

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

Response: We agree that governance and leadership are key to the achievement of engagement quality. However, we are concerned that this is an area where the revised standard is insufficiently scalable/tailored for smaller audit firms, i.e. SMPs and sole practitioners. The IAASB has acknowledged that feedback received identified that SMPs may experience practical challenges in implementing certain proposals and we are disappointed to learn that the IAASB has decided to ignore this feedback and retain these requirements for all firms. We believe that a “bottom up” or “building blocks” approach would present a more suitable, scalable set of requirements in this area.

It is important to distinguish between leadership and culture in these requirements. For example, ED-ISQM1.23a requires “the firm’s culture” to “...promote a commitment to quality”, whereas we believe it would be more appropriate to require leadership to promote such a commitment to quality which then, effectively, permeates into the firm’s culture.

We find ED-ISQM1.23e is trying to fit two objectives into a single requirement and that it would be more appropriate to either split them out or strip back to the requirement to a single objective. The present draft requires the firm to have resource plans to “support the commitment to quality” and also to “enable the design, implementation of the system of quality management”. We feel that simply requiring the resources to achieve the latter will, in effect, demonstrate resources which support the commitment to quality whilst simplifying the requirement.

We do not support the requirement set out in ED-ISQM1.25f. We do not think that is appropriate to have a core requirement in the standard which is only relevant in certain jurisdictions where law or regulation places firms under obligation to comply with a governance code or similar.
We believe that the requirements in ED-ISQM1.24(a)(iii) are not relevant for smaller audit practices, such as SMPs or sole practitioners, and therefore it will not be possible for such firms to meet the requirement to established structures, reporting lines etc. Furthermore, we are concerned that the requirement in ED-ISQM1.24b will be very difficult, if not impossible, to achieve in smaller practices as there will be nobody able to perform such periodic evaluations of, for example, the managing partner in a single partner firm. Similarly, the requirement in ED-ISQM1.24c will also be very difficult to achieve in practice in a small firm (e.g. single partner). These are good examples of where we believe that the scalability of the standard would be enhanced by taking a “bottom up” approach of developing requirements that could apply to the smallest firms, with additional requirements for larger, more structured firms.

Finally, we note that para 48 of the explanatory memorandum attempts to clarify the requirements of ED-ISQM1.20 around understanding of the ISQM. We find it very difficult to reconcile an individual having responsibility for the system of quality management but NOT having an in depth understanding of the contents of ED-ISQM1. We believe that the amended wording is semantics only, and that to be truly responsible for quality management the individual assigned responsibility should have an understanding of the standard. Furthermore, ED-ISQM42c and ED-ISQM1.55 require the individual with ultimate responsibility to evaluate whether the system of quality management provides reasonable assurance that the objectives of the standard will be achieved; we cannot envisage how this evaluation can be effected without a detailed understanding of the standard. We do not support this change from extant ISQC1.

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?

Response: We agree with suggestions from IESBA that the requirements in ED-ISQM1 should more broadly capture responsibility for ethical matters rather than focusing solely on independence. This would strengthen the importance of the ethical standards in totality since, after all, those standards are referred to as the “Code of Ethics for Professional Accountants, including international independence standards” which reiterates their broader importance.

Therefore, we propose that ED-ISQM1 requires that firms assign responsibility for relevant ethical requirements, including independence, to an individual (or individuals) in the firm. In this way firms may assign overall responsibility to a single individual (e.g. “Ethics Partner”), more than one individual or use delegation powers to enable another individual to be responsible for independence specifically.

In expanding the above requirements as we propose, we also propose expanding the requirement in ED-ISQM1.33d such that the firm should “obtain, at least annually, documented confirmation of compliance with ethical requirements, including independence, from all personnel required to comply with relevant ethical requirements”.

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

Response: We have no comments.

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

Response: Given the rate of change in technology, and the significant variation in complexity of firms, the standard should remain relatively agnostic in relation to the use of technology in the system of quality management.
management. This will help to ensure it is truly scalable to the needs of different types of firms whilst also future proofing the standard against changes in technology. As such, we have no detailed comments on the current content of the ED which seems appropriate.

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?

**Response:** The current quality objective in ED-ISQM1.40e is clear but the required response in ED-ISQM1.41c lacks clarity. In particular, the required response to produce a transparency report “when the firm determines it appropriate” is ambiguous and difficult to apply consistently. If the IAASB considers that firms should produce a transparency report, then it should be bold enough to say so in the standard by including a clear requirement. However, if the IAASB doesn’t consider this a necessity then it should not include such a “required” response which isn’t really required unless the firm wishes to do something. For the avoidance of doubt, we do not believe that all firms should be required to publish a transparency report on the grounds of practicality and applicability to firms of all sizes.

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?

**Response:** The requirements for EQR as set out in ED-ISQM1.37e should enable firms to identify engagements for which an EQR is appropriate, with the exception of those considered to be of “significant public interest” (ED-ISQM1.37e(ii)). There is currently no accepted definition of Public Interest Entities and the lack of clarity is exacerbated by the wider phrase used here of “significant public interest”. Many firms may find it difficult to establish their own definition if standard setters are unable to clearly define what they mean. We note that the application material uses phrases such as “large number and wide range” with no clarity as to how these benchmarks should be applied. We would urge the IAASB, IESBA and others in the profession to develop an appropriate definition of “public interest entities” that can be applied consistently (with additional jurisdictional requirements added as appropriate).

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

**Response:** Overall, we support the proposals for monitoring and remediation and believe that these will enhance the robustness of current arrangements. We do, however, have comments on some of the proposals.

ED-ISQM1.42c requires the individual assigned ultimate responsibility for the SOQM to evaluate whether the system provides reasonable assurance that objectives will be achieved. We cannot see how the individual assigned ultimate responsibility can evaluate reasonable assurance without having a detailed understanding of the standard (see comments elsewhere regarding ED-ISQM1.20).

ID-ISQM1.52 requires that the individuals assigned operational responsibility communicate certain matters on a timely basis to the individual assigned ultimate responsibility and accountability for the SOQM. However, the standard does not describe or explain what should happen in instances, typically in smaller firms, where the two roles are undertaken by the same individual. To what extent is documentation required in this instance?
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?

Response: Whilst we agree that the proposals are likely to improve monitoring, and do include reference to innovative monitoring techniques, we are concerned with the practicality of the application of these requirements, particularly for SMPs. Innovative techniques are more likely to be driven in larger firms and we would encourage sharing of knowledge and experience of the application of such techniques to the extent that they may be applicable to smaller firms. Whilst we support the ongoing requirement for reviews of completed engagements (see comments elsewhere), we would note that the application of such techniques will be over and above the existing requirement to review completed engagements and therefore firms may be discouraged from applying these techniques if they are seen as an additional burden rather than replacing other activities.

ED-ISQM1.46b sets out requirements relating to the objectivity of those performing monitoring activities, which will include reviews of completed engagements. It is not clear from the standard how this can be achieved in smaller firms, particular single partner firms. Further illustrative guidance would be helpful to identify how smaller firms can achieve compliance with these requirements.

(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?

Response: Yes, we fully support the ongoing requirement to undertake inspections of completed engagements. However, as currently drafted ED-ISQM1.45 lacks clarity as it appears to give firms the option of inspecting “either” in-process or completed engagements in ED-ISQM1.45 but then goes on to refer (in ED-ISQM1.45b) to inspection of completed engagements.

We are strongly of the view that the requirement should explicitly state that completed engagements be subject to inspection and that firms may, in addition, undertake inspections of in-process engagements. The review of in-process engagements does not necessarily include inspection at all stages of the audit, in particular at the completion stage.

Furthermore, the requirement in ED-ISQM1.45b is for a cyclical review of completed engagements for each engagement partner, with application material referring to an example of three years. Whilst this is perfectly understandable for larger firms with numerous partners, it is not clear how the IAASB expects this requirement to apply in smaller firms with fewer partners (e.g. single partner firms). Given there is a requirement for an annual evaluation of the effectiveness of the SOQM in achieving the objectives of the standard, it is difficult to envisage how an annual evaluation could be performed if no completed engagements are reviewed in any given year which would appear to imply that, for a single partner firm, a review of completed engagements is required each year. The IAASB should clarify the application of this important requirement for smaller firms.

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

Response: We do not consider that there is sufficient clarity around the definitions of “findings” and “deficiencies which has the knock-on effect that it is difficult to clearly define the scope of root cause
analysis. Allied to the lack of clarity over these definitions is the scope of the application of root cause analysis, i.e. to which deficiencies root causes analysis is to be applied. (see below)

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

Response: We agree with the introduction of the requirement to investigate root causes. We note that the standard requires firms to identify the root causes of deficiencies identified in the system of quality management. However, the standard is not clear how root cause analysis should be applied to the findings (or deficiencies) arising from quality inspections, either external or internal. We are of the view that the application of Root Cause Analysis is equally, if not more, important to those findings arising from quality inspections of completed engagements in driving further improvements in audit quality at the engagement level. We suggest therefore that the standard is revised further to clarify the application of root cause analysis to findings from quality inspections.

In particular:

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

Response: See comments above. Whilst there is flexibility in the application of root cause analysis we believe further clarity is required in relation to its application for findings arising from quality inspections of completed engagements.

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

Response: Whilst we understand that the focus of root cause analysis is on "negative" findings, we do feel there are significant benefits to identifying the root cause of positive findings arising from inspections of audit quality inspections. The assessment of positive outcomes from inspections is especially important in promulgating good practice and, whilst it may be of limited benefit to the evaluation of the system of quality management, in clarifying the application of root cause analysis to quality inspections (see above), we believe that the IAASB could introduce greater clarity of the benefits of analysis of positive findings in this context.

(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?

Response: Please see comments elsewhere where we have expressed a concern that the individual with ultimate responsibility is required to evaluate the SOQM but is not required to have an in-depth understanding of the standard. We cannot envisage how these two requirements are compatible.

Further, we envisage considerable difficulty for smaller firms in complying with the requirement to undertake an annual evaluation of the entire system of quality management each year without greater guidance and illustrative practical examples to assist them in this process.

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?

Response: We believe that the proposals addressing networks are reasonable and proportionate and are clear in identifying that the responsibility for the SOQM lies with the individual firm at all times. These
requirements will place an additional burden on the networks to provide sufficient information for the firms in certain situations, but we do not consider these to be unreasonable.

In respect of the risk assessment process (ED-ISQM1.59) the standard implies that the individual firm may be able to place reliance on the quality reviews undertaken by the network. Whilst the firm would be expected to take account of the findings of the network’s review in conducting its own review program, the firm is responsible for its system of quality management and for its engagement quality. We do not consider it to be appropriate for the firm to replace its own quality review program with the network reviews of completed engagements. Greater clarity in this area would be beneficial, including that a firm must include a review of completed files as part of its SOQM. Further guidance on the factors which may influence the timing and extent of the firm’s review program would be helpful.

14) Do you support the proposals addressing service providers?

Response: As with networks, above, we believe that these proposals are reasonable and proportionate. It is not unreasonable to expect firms to have the required understanding of service providers. These proposals are in reality a more formalized approach to something which most firms would do in making the determination to use a particular service provider.

However, what is less clear is whether the understanding should be formalized with reports such as an ISAE 3402 report on the controls at the service provider. If this is the intention or expectation then the standard should be clarified, and it is important that the IAASB provides guidance and illustrative examples to assist smaller firms in complying with these requirements as it may not always be easy to obtain the required assurances from service providers. In addition, it is important to consider what firms would do in a situation where such assurance is not available from the service provider as there is currently no obligation for them to provide such information.

15) With respect to national standard setters and regulators, will the change in title to “ED-ISQM” create significant difficulties in adopting the standard at a jurisdictional level?

Response: We have no comments.

Other comments not covered by the questions above

In addition to the responses to the questions posed above, we have the following comments on the proposals in the revised standard:

Acceptance and continuation of client relationships and specific engagements

Given that firms will be required to demonstrate compliance with the requirements of the standard, we struggle to see how any firm will be able to demonstrate that its “financial and operational priorities do not lead to inappropriate judgements whether to continue or accept…” (ED-ISQM1.34c). This difficulty is exaggerated by the lack of required responses developed by the IAASB in this area. It may only be possible to provide “negative assurance” in this regard, i.e. that no instances where inappropriate judgements were made have been identified.

Information and Communication

The requirement for firms to establish an “Information system” (ED-ISQM1.40a) will be extremely difficult to achieve in practice for SMPs and sole practitioners to whom the standard applies. Whilst it is easy to envisage what such an information system might look like in a larger firm, it is very difficult to envisage what this would look like in a smaller firm, and even more so how such a firm could demonstrate its arrangements to a regulator. This is another example of where true scalability of the standard would be better achieved through a building blocks approach.
Resources

We note that there are no required responses developed by the IAASB in ED-ISQM1.39 which is particularly disappointing given that there are seven control objectives. If the IAASB is unable to identify appropriate responses to meet the objectives, we contend that it will be difficult for individual firms, in particular SMPs, to identify appropriate responses.

Yours faithfully,

Paul Winrow
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