



中国注册会计师协会

The Chinese Institute of Certified Public Accountants

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

July 12, 2019

Dear Mr. Botha,

The Chinese Institute of Certified Public Accountants (CICPA) is the only national professional accounting organization, representing the certified public accountants in China. CICPA has over 250,000 individual members, among whom 110,000 are practicing members. As the National Auditing Standards Setter for Chinese accounting profession, CICPA appreciates the opportunity to comment on 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 ("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-ISA 220"), (collectively the "Proposed Standards"). Our response is informed by input from CICPA members with extensive experience in audit and assurance, as well as audit regulators in China.

CICPA commends IAASB's initiatives to further strengthen firm's quality management and improve audit quality in order to better serve the public interest. We believe that the Proposed Standards advance with times, respond to the concerns of audit regulators, follow the trend of rapid development of information technology and reflect the best practice of governance and quality management in accounting firms.

In response to questions raised by IAASB regarding the quality management project, we have some comments, which are set out in detail below.

I. Comments on the Overall Explanatory Memorandum

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?

On one hand, time is limited considering that it takes a certain amount of time to establish and improve the quality management system and rectify defects. On the other hand, it is better to upgrade the quality management system and improve engagement quality as early as possible.

All things considered, it is reasonable that the effective date is 18 months after final approval, meanwhile early adoption is encouraged.

In order to avoid misunderstanding, we recommend it be made clear in the Proposed Standards the expectation of firms as at the effective date. Is the firm expected to be able to conclude that its system of quality management complies with and meets the objectives in the Proposed Standards, or the effective date of the Proposed Standard indicates when the firm embarks on complying with the Proposed Standards.

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?

The standards are principle-based. However, SMPs face greater limitations in capacities and resources to understand and implement the standards. Therefore, they need more practical guidance. We appreciate IAASB's support for implementation of the standards. We think the draft examples and draft frequently asked questions provided on IAASB's website are useful. However, the examples are mainly focused on relevant ethical requirements, which is a relatively simple component. We recommend IAASB provide more detailed guidance on components such as governance and leadership, resources, etc.

3) Developing Nations—Recognizing that many developing nations have adopted or are in the process of adopting the International Standards, the IAASB invites respondents from these nations to comment on the proposals, in particular, on any foreseeable difficulties in applying it in a developing nation environment.

Audit firms have only a relatively short period of development in developing countries. Overall, there is still a big disparity in governance and management compared to firms in developed countries. Audit firms are facing great pressure of human resources, financial resources, technological resources, and intellectual resources shortage, etc.. The proposed standards have enhanced requirements in those areas, which brings great challenges in applying them in a developing nation environment.

4) Translations—Recognizing that many respondents may intend to translate the final ISQMs and ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues respondents may note in reviewing the proposed standards.

Some sentences are long and complex, such as paragraph 23, 24 and A29 of ISQM 1, which makes it difficult to read and understand.

Some expression can be more concise and more reader-friendly. We recommend applying the principles of the IAASB's Clarity Project. For example, paragraph 48 of ED-ISQM 1 (*The firm shall establish policies or procedures addressing: (a) The investigation of the root cause(s) of the identified deficiencies...*) does not explicitly state that the firm should investigate the root cause(s) of the identified deficiencies, which we believe is the real intention.

Different words are used to express similar meaning without explanation for their differences, which brings confusion in understanding and translating for non-English speakers. For example, it's hard to tell the difference between *analysis* and *assessment* in the first sentence of paragraph A180 in ED-ISQM 1 (*Performing a root cause analysis generally involves those performing the assessment exercising professional judgment based on the evidence available*). Suggest clarification in wording.

For new terminologies, such as *intellectual resources*, *scalability*, etc., it is recommended to provide a more explicit explanation, so that non-English speaking countries can do better in translation.

The 2 questions below are from ED-ISQM 1. However, we believe it is also relevant to ED-ISQM 2 and ED-ISA 220. Thus we put forward here as our overall comment.

5) 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 scalability has been improved, meanwhile the ability to understand and implement the standards also need to be enhanced (e.g., greater exercise of professional judgment), which brings great challenges, especially to SMPs. While the standards provide flexibility in terms of size, complexity and circumstances, SMPs may not be able to accurately understand and apply these requirements in practice. Thus they may be hesitant or may not know how to apply scalability as allowed in the standards. We fully understand and support the principle-based approach. However, we still recommend that IAASB continue to improve the ability of the standards to be implemented in practice, such as developing more guidelines and implementation aids.

In order to improve the scalability, the length of the standard has been substantially increased, which further increases difficulties in reading. It may be harder for SMPs to accurately identify the provisions specifically designed for them in terms of scalability. Besides, business in SMPs is much more diverse compared to that in large firms. It may not be enough to address SMPs' demand only by simplifying and lowering the requirements which are more applicable to large firms in extant standards. Therefore, we think that one set of standards may be difficult to achieve real scalability for SMPs.

6) 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?

The application material is helpful in supporting understanding of the requirements by providing more specific explanation. However, we found some contents in the application materials may not need to be given lengthy explanation and repetition, such as paragraph A45 and examples in A82 of ISA 220. Meanwhile, there is not enough explanation for some factors critical to firm's quality management and audit quality, such as profit sharing arrangements, performance evaluation, network service, inspection of in-process engagement, etc. For another example, some firms are still confused about how to effectively deal with differences of opinion. Guidance in this regard is too simple (paragraphs A93-A94 of ISA 220). We suggest that more practical guidance is needed.

ED-ISQM 1 requires that evaluation of the quality management system shall be undertaken at least annually. However, there is not sufficient guidance. How far should firms go? Is it required to be done like self-assessment of internal control? Is it allowed to evaluate the system based on monitoring results rather than undertaking a separate formal process? Suggest further explanation.

The proposed standards do not provide clear explanation on the relationship of engagement quality review and other quality management process such as monitoring and remediation,

inspection of in-process engagement, etc., what their responsibilities respectively are, and how they coordinate and collaborate. Suggest further explanation.

ED-ISQM 1 only indicates that risk assessments are both ongoing and periodic. The risk-based approach is a key concept of the standard, and risk assessment process is a significant component of the quality management system. Thus, we recommend more guidance. For example, is there any further guidance on the frequency of risk assessment? Should firms take any additional and specific risk assessment procedures with comprehensive consideration of factors such as frequency and severity of defects?

Overall, we recommend that standards should be reasonably detailed. We believe it's helpful if application materials could further focus on those critical issues that firms really need practical guidance on.

II. Comments on ED-ISQM 1

1) 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?

ED-ISQM 1 is likely to be challenging for SMPs due to their lack of experience, resources and ability, and weakness in professional judgement. For example, ED-ISQM 1 introduced a new approach of risk assessment process which includes 3 steps: establishing quality objectives, identifying and assessing quality risks and designing and implementing response. ED-ISQM 1 has provided specific quality objectives and responses to each component of the quality management system. However, the standard does not explicitly indicate the relevant quality risks. In practice, firms need to identify and evaluate quality risks according to their own situation. For another example, it is allowed by ED-ISQM 1 that the quality management system applicable to SMPs could be simplified accordingly. Although the requirements are scalable and flexible, SMPs may still find it difficult to adequately understand, grasp and use those requirements in practice to develop suitable quality management systems.

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

We suggest that IAASB further explain the new quality management system and its eight components, especially the relationship between COSO components and the other three components, and clarify the relationship between quality objectives and internal control objectives.

The quality management system should be based on quality management theory. ED-ISQM1 does not provide any theoretical support, which makes it unclear to explain why the quality management system is composed of these eight components. Are there any other factors that can be considered as a separate component of the quality management system? For example, professional skepticism, professional judgment and fees are also critical to audit quality. Can each of them be a separate component? ED-ISQM 1 provides quality objectives on understanding relevant ethical requirements while it does not establish quality objectives on technical standards such as audit standards. These need further theoretical support (quality management theory).

In ED-ISQM 1, eight components of the system of quality management are *governance and leadership, the firm's risk assessment process, information and communication, the*

monitoring and remediation process, resources, the firm's risk assessment process, relevant ethical requirements, acceptance and continuance of client relationships and specific engagements, among which the first five components are based on COSO framework, while the latter three components are based on consideration of areas prone to risk in practice. Although these eight components are practical, we don't think they are set on the same dimension. We are unclear on the relationship between them due to the lack of theoretical underpinnings to explain how these components are arrived at. Besides, the five elements of COSO framework are designed to achieve internal control objectives (reliability of financial reporting, operating efficiency and compliance). However, ED-ISQM 1 does not explain the relationship between quality management and internal control objectives. We believe that extant quality management system focuses more on compliance, such as compliance with audit standards and relevant ethical requirements. It seems inconsistent because the quality management system uses components from COSO framework but leave out COSO objectives. It is also confusing that ED-ISQM 1 requires that firm's risk assessment process should be applied to the other components of quality management system while COSO framework does not have such requirements.

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

The Governance and Leadership component is based on Control Environment in the COSO framework. However, we found that some elements of Control Environment are also applicable to the quality management system. But they are not covered by Governance and Leadership. In establishing quality objectives for Governance and Leadership, it is recommended that the following aspects be further improved. For example, there is no direct corresponding quality objective in terms of governance structure in ED-ISQM 1. For another example, performance evaluation and profit sharing arrangement is an important part of human resources policies. ED-ISQM 1 focuses only on the leadership who is responsible for quality management rather than all partners. As the third example, the quality objective of organizational structure is suggested to be explained. Because audit quality of different branch offices is uneven. The importance of branch office management is supposed to be highlighted.

4) 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?

Agree. We suggest further clarifying the scope of engagement quality review in group audit.

5) 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 think there is over-reliance on the network provided guidance at the firm level without considering local situation and take responsibility to design, implement and operate the system of quality management to meet local regulator expectations. In paragraph 14 of ED-ISQM 1, we fully agree the firm remains responsible for its system of quality management when considering and implementing network provided guidance and using network provided services. However, the standard does not explicitly state that the firm needs to design, implement and operate system of quality management at firm level based on local considerations such as laws, regulation, oversight framework, and market environment (bottom up approach). We are concerned that the firms will place undue reliance on network

provided guidance (top down approach) without doing proper assessment at local level. The firm is evaluated by local regulators on the effectiveness of quality management, therefore, it is important for the standards to be clear that firm should perform both top down and bottom up approaches in designing, implementing and operating the firm's system of quality management.

6) other

Relevant ethical requirement:

Suggest explicitly stating as a quality objective of relevant ethical requirements that performance evaluation and compensation of individuals within the firm should support and not result in impairment of the independence of engagement partners or engagement quality reviewers.

III. Comments on ED-ISQM 2

1) 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 are supportive of the requirements for eligibility in ED-ISQM 2.

We notice that an engagement quality reviewer could be an external individual appointed by the firm, i.e., supplementing insufficient internal resources with external resources, which is a service provider. This should be subject to paragraph 64-65 of ED-ISQM 1. We believe that, in general, there should be some restrictions on the scope of accounting firms' use of external service providers. Firms are responsible for making sure it has sufficient resources, rather and should not than place overreliance on service providers. Besides, we recommend that IAASB further consider whether certain restrictions should be imposed on the use of external engagement quality reviewer in high risk engagements, such as audit of financial statements of listed entities, important financial institutions, entities of significant public interest, etc.

Suggest explicitly stating in the standards that policies and procedures of accounting firms should ensure that the engagement partner cannot interfere with the appointment of engagement quality reviewer, nor shall the engagement quality reviewer be accountable to the engagement partner or any business unit.

2) Do you agree with the enhanced documentation requirements?

Agree. Suggest further specifying in paragraph 27 that the documentation of the engagement quality review shall include important issues such as the discussion between the engagement quality reviewer and the engagement team on significant judgments.

IV. Comments on ED-ISA 220

Other

1. The definition of engagement management reviewer in ED-ISA 220 is different from that expressed in ED-ISQM 1 and ED-ISQM 2. Suggest further clarification.

2. When comes to the definition of *engagement partner*, what does *other individual* mean? Suggest further explanations or examples.

We hope our comments are of assistance to IAASB. If you have any questions regarding the comments in this comment letter, please do not hesitate to contact Jianhua Tang, Director at tjh@cicpa.org.cn or Shu Duan at duanshu@cicpa.org.cn.

Yours sincerely,

A handwritten signature in black ink that reads "Shu Huihao". The signature is written in a cursive, flowing style.

Dr. Shu Huihao
Secretary General
The Chinese Institute of Certified Public Accountants